

**IMPACT OF NRB DIRECTIVES IN REAL ESTATE
FINANCING**

(A CASE STUDY OF KATHMANDU VALLEY)

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RECOMMENDATION

This is to certify that the Thesis

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Entitled:

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FINANCING**

(A CASE STUDY OF KATHMANDU VALLEY)

Has been prepared as approved by this Department in the prescribed format of the Faculty of Management. This thesis is forwarded for examination.

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And found the thesis to be original work of the student and written in according to the prescribed format. We recommend the thesis to be accepted as partial fulfillment of the requirement for the Master's Degree in Business Studies (M.B.S.).

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DECLARATION

I hereby declare that the work reported in this thesis entitled **IMPACT OF NRB DIRECTIVES IN REAL ESTATE FINANCING (A CASE STUDY OF KATHMANDU VALLEY)** Submitted to Shanker Dev Campus of Management, Tribhuvan University is my original work done in the form of partial fulfillment of requirement for Master's Degree of Business Study (MBS) under the supervision of **Prof. Snehalata Kafle** of Shanker Dev Campus.

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ABBREVEATIONS

EPS	:	Earning Per Share
ERR	:	Expected Rate of Return
F/Y	:	Fiscal Year
GDP	:	Gross Domestic Product
HPR	:	Holding Period Return
LTD	:	Limited
NBA	:	Non Banking Assets
NPA	:	Non Performing Assets
NPL	:	Non Performing Loan
NRB	:	Nepal Rastra Bank
T-BILLS	:	Treasury Bills
TU	:	Tribhuvan University
NPAT	:	Net Profit After Tax
CL	:	Current Liabilities
CA	:	Current Assets
CRR	:	Cash Reserve Ratio
IMF	:	International Monetary Fund
BHBFC	:	Bangladesh House Building Finance Corporation
DFIS	:	Development Finance Institutions
NABIL	:	NABIL Bank Ltd.
HBL	:	Himalayan Bank Ltd.

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CHAPTER I

INTRODUCTION

1.1 Background of the study:

Real estate refers to the immovable property such as land, land and house or any type of building or infrastructure used for either residential or business or any other purposes. Until recently, investment in real estate sector was increasing in Nepal due to lack of alternative investment opportunity in the country. The increase in the demand for land, especially in urban areas, is attributed to the inelastic supply of land and absence of viable investment opportunity. The speculative assumption of people that price of real estate will never decline and it is the safest sector to invest, has played an instrumental role in increasing in the real estate price.

Since the past few years, remittances have become the most important source of financing economic activities in Nepal. Lack of employment opportunities accompanied by political instability and delayed peace process in the country pushed thousands of Nepalese workers abroad for employment. This resulted into massive inflows of remittances accounting for about 20 percent of GDP. With accelerating growth of remittances and lack of alternative investment opportunities, huge amount of money has gone into land and housing business that created a real estate boom. The proliferation of financial institutions together with an excess liquidity situation in the past also fueled the real estate boom, especially in the urban areas.

According to the IMF (2010a) “the land transactions in the urban area almost doubled in 2009 alone compared to the previous year and the prices in the Kathmandu valley were reported to have quintupled in some areas in the recent years. However, in response to the corrective measures undertaken by the NRB, these trends have started reversing in the recent months.” The tendency of migrating from rural areas to urban has fueled the real estate business in Nepal. Basically people are purchasing real estate (land or land with house) for two general motives: first, for self residence and second, for business purpose. The first motive has boosted up the second one. There are different views pertaining to the extent the motive of self residence has shaped the business scenario in Nepal. The banks and financial institutions are

financing in real estate sector as one of the important sector for lending. In the loan portfolio of banks and financial institutions the real estate lending has a significant share. Similarly, in the composition of collateral types, house and land holds 61 percent of share (NRB, 2010).

According to the IMF (2010a) “Although banks’ direct exposure to real estate and housing loans is not particularly high at about 20 percent of the total loan portfolio, the actual exposure could be higher due to loan misclassification problems. In addition, total exposure, including loans collateralized with real estate properties, account for 70 percent of total.”

Due to upsurge in loan in real estate, the NRB has issued some regulatory directives to banks and financial institutions to limit the loan flow in real estate. The Monetary Policy of 2010/11 has provided some guidelines for real estate financing. Paragraph 59 of the policy urges bank and financial institutions to curb down the real estate and housing loan to a specified limit. This is to reduce the risk associated with the high concentration of loan in a single sector. Similarly, paragraph 98 of the policy has reduced the limit in housing and residential lending. It has also restricted lending to 10 percent limit in land purchase and plotting (NRB, 2010).

The real estate business is being done largely in the unorganized sector those purchases large area of land and do plotting with or without developing residential facility. However, there is a growing trend to develop land and construct residential housing by organized real estate developers. The organized sectors are those which are formally registered institutions for the real estate business that are involved in developing mass residential infrastructures. They are basically involved in purchase of large area of land and developing the land with proper planning along with various residential facilities. They can often sell the plotted land with basic infrastructures. The organized 3 sector comes under the government law and regulations, but the unorganized sector generally does not come under the law and regulation of government.

1.2 Statement of the Problem

The development of any sector in the economy needs financing. Real estate sector is not an exception; it certainly needs continuous and huge investment. Nepal, being a developing country with limited infrastructure and lack of accumulated capital, seriously requires huge

investment in most of its socio-economic sectors. Further, real estate, being a capital-intensive industry, also demands considerable amount of capital for the infrastructure. This is also required for the expansion, growth and sustaining of the sector. In addition to this, more financing is necessary for the support services and for the promotion of related industries. Moreover, adequate supply of financing also facilitates the overall growth of the country.

Until recently, the increasing demand for finance in the real estate sector and supply of financing by BFIs have been the serious economic issues in Nepal. Nepal Rastra Bank, being the central bank of Nepal, has a basic concern to discourage risky lending in real estate and encourage lending in productive sectors for the country's economic growth. It is against this background that this study on real estate financing is undertaken.

1.3 Objectives of the Study

The present study is confined to the financing aspect of real estate sector. This has been further categorized into the supply side and demand side. The banks and financial institutions that finance real estate financing pertain to the supply side and individual household, real estate buyer, the professional real estate developers or business persons or institutions pertain to the demand side.

The study's primary objective is to measure and classify the real estate financing in Nepal. The specific objectives are

- a) to examine the scenario of real estate financing undertaken by banks and financial institutions in Nepal;
- b) to identify the real estate financing procedure by banks and financial institutions; and
- c) to assess the impact of policy changes on real estate financing in Nepal.

The present study, therefore attempts to address some fundamental questions related to the real estate sector and financing in Nepal. The present study, therefore attempts to address some fundamental questions related to the real estate sector and financing in Nepal.

-) What is the current position of real estate financing in Nepal?
-) What was the growth rate of real estate financing during the last 3 years?
-) What is the lending procedure followed by banks and financial institutions for real estate financing?

-) What is the impact of directive issued by the NRB particularly on real estate sector lending?

1.4 Methodology of the Study

1.4.1 Data Sources and Research Design

The study is based on data collected from both primary and secondary sources. The primary data for the study are collected from the questionnaire survey. The secondary data are collected mainly from various publications of Nepal Rastra Bank and Ministry of Finance as well as from various newspapers, magazines, journals and internet. In addition, some data are collected directly from banks and financial institutions. To supplement the secondary data, some primary data have also been used which are collected through interviews and personal contacts.

The present study is of analytical and exploratory nature. It has utilized various mathematical and statistical techniques to analyze the existing status of housing and real estate financing.

1.4.2 Population and Sample

As the study tries to incorporate the existing status of real estate financing, it has categorized the population into three groups: first, the banks and financial institutions that supply financing for real estate; second, the real estate developer that demand real estate financing from banks and financial institutions; and third, the real estate buyer who come at the Land Revenue Offices to transfer the ownership of land and building in their name.

The samples are selected considering the real estate exposure of the banks and financial institutions under Group 'A'. Housing companies and professional real estate developers (Group 'B') were selected from the members' list of Nepal Land and Housing Developer's Association. However, the process of sample selection under Group 'C' was different. The customers that come to Land Revenue Offices to purchase land, house or apartment are directly selected as samples.

1.5 Significance of the Study

Since the last few years, lending by banks and financial institutions in real estate sector has increased remarkably with the concomitant increase in the risk in financial system. In order to limit the risk, the NRB has issued some regulatory directives to banks and financial institutions to limit the loan flow in real estate. However, there is need of a study to identify the optimum composition of real estate loan in the loan portfolio of banks and financial institutions for facilitating the central bank to have a particular policy stance regarding real estate financing. Proper regulation is desired in real estate sector and absence of which may reflect improper way of financing the real estate projects. That is why it has become necessary to identify the status of real estate financing, financing procedure and impact of directive in the real estate financing. Again, this type of study has not been conducted in Nepal. The study will be helpful in capturing the existing real scenario of real estate sector and can make plausible policy recommendations for formulating necessary regulatory policy guidelines for the real estate sector.

1.6 Limitations of the Study

The study has tried to present briefly the overall financing situation of real estate sector in Nepal, in general, and Kathmandu Valley, in particular. Nevertheless, the study is constrained with the following limitations.

- NRB's Directive for real estate lending has been subject to amendments from time to time. This has certain effects on the data maintenance and product-wise loan classifications. Therefore, it is difficult to construct the time-series data for analytical purposes.
- Demand for and Supply of real estate financing could not be estimated from available data.
- Some respondents from Group 'B' and many from Group 'C' seemed reluctant to respond to the questionnaires and disclose the facts and figures.

1.7 Structure of the Study

The study is divided into five chapters. The next chapter briefly reviews the most relevant literature regarding housing and real estate sector with due focus on the financing aspects of real estate sector.

The third chapter examines the policies and practices of housing and real estate financing in Nepal whereas the fourth chapter summarizes the survey response from banks and financial institutions, professional real estate developers and builders as well as from customers that purchase the land, building or apartment. Finally, the concluding chapter summarizes the findings and also makes suggestions for the overall development of the real estate sector.

CHAPTER II

REVIEW OF LITERATURE

2.1 Conceptual Framework

Housing provides shelter. As it is a basic need of every human being, it provides security, pride and ownership. It has great significance in human life. Real estate is a legal term that encompasses land along with improvements to the land, such as buildings, fences, walls and other site improvements that are fixed in location-immovable (http://en.wikipedia.org/wiki/Real_estate). Real estate is often considered synonymous with real property (also sometimes called realty), and housing is one component of real estate. Real estate covers both commercial and personal properties.

Housing and real estate sector play an important role in overall economic growth, social uplift, and employment in the context of the rapidly expanding economies. Personal residences account for 75–90 percent of household wealth in emerging-market countries, which amounts to three to six times their annual income.

Housing represents 15–40 percent of the monthly expenditure of households worldwide. Similarly, investment in housing accounts for 15–35 percent of aggregate investment, whereas housing construction and housing-related sectors constitute approximately 9 percent of the labor force worldwide (Nenova, 2010; Sarker et.al, 2011). With the development of private property ownership, real estate has become a major area of business. Purchasing real estate requires a significant investment and each parcel of land has unique characteristics; so, real estate industry has evolved into several distinct fields.

Some kinds of real estate businesses include 1) Appraisal (professional valuation services), 2) Brokerage (assisting buyers and sellers in transactions), 3) Development (improving land for use by adding or replacing buildings), 4) Property Management (managing a property for its owner), 5) Real Estate Marketing (managing the sale side of the property business) and 6) Relocation Services (relocating people or business to different country) (Singh et al, 2009).

The main participants in real estate markets are:

-) Owner/User - These people are both owners and tenants. They purchase houses as an investment and also to live in.
-) Owner - These people are pure investors. They do not consume the real estate that they purchase. Typically they rent out the property to someone else.
-) Renter - These people are pure consumers.
-) Developers - These people prepare raw land for building which results in new product for the market.
-) Renovators - These people supply refurbished buildings to the market.
-) Facilitators - This includes banks, real estate brokers, lawyers, and others that facilitate the purchase and sale of real estate.

(Source: http://www.edinformatics.com/real_estate/real_estate_economics.htm)

The owner/user, owner and renter comprise the demand side of the market, while the developers and renovators constitute the supply side. The unique features of the real estate market such as durability, heterogeneity, high transaction cost, long time delays, use as both consumption and investment goods and immobility, among others, distinguishes it from other markets (Singh et al, 2009).

According to Singh et al. (2009), the following factors influence the price and cost of the real estate:

-) Physical characteristics of the property
-) Property rights
-) Time horizon of holding the property
-) Geographical area
-) Development rate

Though real estate markets have grown dramatically over the years, there are concerns about its impact in the economy. Given the lumpiness and long-term nature of real estate investment, the misallocation of resources through bursts of irrational exuberance and subsequent under-utilization may indeed be especially undesirable.

Excessive bank lending to the real estate sector was one of the responsible factors that led to the Asian financial crisis and the recent global financial crisis. The excessive risky lending of banks and financial institutions created the inflation of asset prices. A large body of literature has examined the role of the banking sector in propagating business cycles. In the aftermath of the Asian financial crisis, many researchers have examined the role played by the real estate sector in the crisis, and have argued for reforms in the regulation of the real estate markets and the treatment of real estate loans by financial institutions in order to prevent the recurrence of the kind of asset bubbles that contributed to the financial crisis (Koh et al, 2004). The recent financial crisis has drawn worldwide attention and there have been proliferation of literature regarding the devastating impact of the real estate boom and bust on the economy. The global financial turmoil raised issues on how central banks should respond to asset price bubbles. Asset prices have played a more prominent role in monetary and financial stability frameworks. They have acted as sources of information on market expectations and markets' risk attitudes; leading indicators of output, inflation and financial distress; and indicators of shocks that hit the economy. They also provide signals to profitable investments, affect the wealth of households, and influence the cost of capital to firms and households. Thus, asset prices are useful in that they provide policymakers forward-looking information. However, once asset price bubbles develop and eventually burst, they can lead to widespread financial and economic disruptions (Laquindanum, 2010).

Credit concentration in certain sector of the economy has attracted the attention of both regulators and business enterprises. A variety of measurement and management techniques have been developed to review such concentration. The measure, most often used to express risk levels in general, is credit exposure. Exposure indicates the level of loss should a credit event occur, in the absence of mitigating credit terms and conditions.

An asset bubble is a sharp rise in the price of an asset or a range of assets in a continuous process, with the initial rise generating expectations of further increases in asset prices and attracting new buyers—generally speculators who are more interested in profits from trading in the asset rather than its use or earning capacity (Laquindanum, 2010).

Typically, it is calculated as the total amount at risk, adjusted for mitigating factors such as netting and collateral. Other factors determine the credit quality of the name and the nature of the exposure. These factors are typically incorporated into measures of probability of default (PD), or rating, and loss given default (LGD). The tendency for losses to bunch together (and create problems) is quantified through correlation. Capturing correlation, along with the other key factors of exposure, PD and LGD leads to a measure such as credit value-at-risk defined at a particular confidence level (Reynolds, 2009).

The International Monetary Fund (IMF) has developed the financial soundness indicator (FSI) to respond to the need for better tools to assess the strengths and vulnerabilities of the financial system. Among the various indicators, there are four indicators related to the real estate market viz.

1. Residential real estate prices,
2. Commercial real estate prices,
3. Residential real estate loans to total loans and,
4. Commercial real estate loans to total loans

(Source: <http://www.imf.org/external/np/sta/fsi/eng/fsi.htm>).

However, the country definitions of the above indicators may vary significantly.

Table 2.1 provides a glimpse on some of the FSI indicators.

Table: 2.1
Real Estate Loans in Some Economies

	Armenia	Bhutan	Latvia	Mauritius	Philippinea	Romanin	Russia	Turkey
	Dec 2010	Q4 2010	2010	Q4 2010	2010	2010	2010	Q4 2010
Residential estate loans total loans	11.2	24.6	27.2	6.8	6.6	18.1	5.8	10.7
Commercial			19.3	2.1	6.8	24.6	6.3	0.8

real estate loans to total loans								
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Note: Q4 means fourth quarter of the year.

Source: IMF (2012b)

2.2 Real Estate Financing

McKinney, Jr. (1952) has identified four sources of real estate financing (in the order of contribution) during the housing boom in the United States, such as savings and loan associations followed by commercial banks, insurance companies, and mutual savings banks. Edwards, (1964) has also pointed out that savings and loan associations continued to grow more rapidly than other mortgage lenders. They cited the use of these institutions as the dominant force in the home mortgage markets. In spite of an increasing focus on urban housing and development, informal systems are still the dominant producers in many developing countries. It is estimated that 60 to 70 percent of Mexico's and Brazil's current housing stock is built informally because current value chains are not adapted to the needs and realities of this growing market (Franck and Ferguson, 2004). The informal sources of informal finance have lesser legal formalities and have developed good relationships with customers. They are popular even if they charge exorbitant interest rates (Schmidt and Budinich, 2006).

According to the Housing Finance Group of the International Finance Corporation (IFC), housing finance contributes to social stability by enabling households to purchase an asset which represent their largest single investment. Personal residences account for 75 to 90 per cent of household wealth in emerging market countries, which amounts to 3 to 6 times their annual income. Furthermore, housing represents 15 to 40 per cent of the monthly expenditure of households worldwide. Globally, investment in the housing sector accounts for 15-35 per cent of aggregate investment (Housing Finance Group, 2006).

The Housing Finance Group has identified numerous challenges of the housing finance sector in order to increase the availability and affordability of residential housing in developing countries. These are lending restrictions, infrastructure (emerging markets often lack the

infrastructure that is fundamental to the support of home ownership), regulatory environment, capacity (the pool of skilled managers and field staff experienced in housing finance is limited), and outreach (Housing Finance Group, 2006).

2.3 Real Estate Financing in Some South Asian Countries

Real estate sector is a large, huge diversified sector, one with many verticals such as land, design, construction, development, investment and lending, among others. Real estate development is taking place in residential, retail, office, hotels and industrial sectors. In recent years, real estate markets have grown dramatically. However, real estate financing could not follow the sustainable path over the years. There are various economic and non-economic factors behind this. These factors may vary as per the real estate sector and economic condition of the country.

Although several potential sources of housing finance for mid- and high-income consumers exist, most of the low-income families' needs are still unmet. Government subsidies tend to be insufficient or inappropriate; mortgage markets tend to serve only the richest 10-20 per cent of the population; in spite of its strong value proposition, housing microfinance is still an emerging industry; and informal systems are not efficient. Only 3 per cent of outstanding credit in low income countries is held in the form of housing loans compared to 27 per cent in high-income countries (de Soto, 2003 in Sarker, 2011).

From a regional perspective, the mortgage markets in South Asia are small and fragmented with the unorganized sector. Regarding the organized segments, there are distinct commonalities that characterize some of the mortgage markets of South Asia, such as a heavily subsidized monolith-like state run institution, a fledgling private sector catering to the middle and upper income segments and players from the banking sector that provide housing finance as a part of their retail portfolio. The mortgage markets in Sri Lanka, Bangladesh and Pakistan are such archetypes (Karnad, 2004 in Serker, 2011). A brief discussion follows about the real estate financing in some of the South Asian countries.

2.3.1 India

In India, the large shortage of housing has continuously fueled the growth in the real estate sector. The demand for the affordable residential housing and financing is the main driver for such growth. The rising middle class and its consumer demand is driving the real estate boom in India. For example, for every rupee invested in housing, Re 0.78 gets added to the national GDP and the construction sector provides direct employment to 16 percent of India's workforce; and the housing sector alone is the second largest employment generator after agriculture, accounting for 58 percent of the workforce in the construction sector (Nenova, 2010).

There was a substantial change in the financing system during the late 1990s, against the backdrop of lower interest rates, industrial slowdown, sluggish credit off-take and ample liquidity. In fact, the lower interest rate regime, rising disposable incomes, stable property prices and fiscal incentives made housing finance an attractive business. Further, housing finance traditionally has been characterized by low nonperforming assets (NPAs) and given the vast demand for housing loans, almost all the major commercial banks plunged into the business of housing finance.

Over the years, banks have realized that while the demand for housing loans is tremendous, there is no substitute for prudent lending policies. Some banks have withdrawn from the housing loan market after being saddled with an unduly high amount of nonperforming loans (Karnad, 2004). Further, there have been several problems in the real estate financing with several warnings raised for cautious lending and recovery.

2.3.2 Bangladesh

Sarker et.al (2011), in their paper, have briefly illustrated the real estate market of Bangladesh with problems and prospects of financing. They argued about the residential housing sector of Bangladesh as having three-tier market characteristics. "First are those households with the highest disposable income (less than 3 percent of the housing market), able to afford high-quality housing in fully serviced neighborhoods, and able to utilize bank financing or specialized housing finance institutions. The second tier is the relatively narrow stratum of middle-income households (represents 12 to 15 per cent of the housing market) that are the

main users of specialized housing financial institutions such as Bangladesh House Building Finance Corporation (BHBFC). This group is the major beneficiary of available public subsidies and is composed predominantly of public servants and wage/salary earners of large private companies and public sector corporations. The third and largest of the tiers is the low-income households, for which housing is provided largely by the private sector, often under illegal and unsatisfactory site conditions (ADB, 1995).”

In addition, Sarker et.al (2011) have discussed about the financing mechanism of real estate sector in Bangladesh. While state-owned BHBFC is the major player of real estate financing, other sources of housing finance are commercial banks, employee loans, insurance companies, and informal means. In the rural sector, some housing co-operatives are the major providers of housing finance (Banglapedia, 2005 in Sarker et.al (2011). Moreover, several public agencies, such as the Housing and Settlement Directorate, Public Works Department, Local Government Engineering Department and different City Corporations are involved in the financing and development of housing and residential infrastructure projects.

However, the present housing finance system in Bangladesh is extremely small and highly segmented: formal mortgage finance is only available to households with incomes above BDT 25,000 per month and is restricted to selected housing sub-markets in Dhaka. Government subsidized housing finance through the BHBFC is most prevalent, while the nationalized commercial banks are decreasing their housing loan portfolios. Recently, new private housing finance institutions have started to operate in this market targeting middle income households. Non-collateralized credit for house construction by micro finance institutions is also available to a small proportion of poor rural households. All other households that aspire to home-ownership are dependent on their own savings with additional contributions from relatives, friends or employers, or short-term money-lenders. Given the lack of credit and the overall low levels of income, informal and non-permanent housing prevails, both in urban and rural areas (Sarker, et.al; 2011).

2.3.3 Pakistan

In Pakistan, the formal financial sector provides housing support through two major sources namely the Government-owned House Building Finance Corporation (HBFC) and commercial

banks. The private sector housing finance companies also caters to a negligible consumer base. The formal financial sector caters to only 1 to 2 percent of all housing transactions in the country, whereas the informal lending also caters up to 10% of such transactions. Some studies indicated that lack of finance from a formal source is a primary supply problem. Hence, most of the housing finance is being arranged through personal resources (Shehzad, 2009).

The HBFC was historically providing housing finance to lower or average income group since 1952. In 1994, the Government decided that HBFC should operate as a market oriented financial institution. Commercial banks though providing mortgage loans on a much selected basis entered the mortgage business during 2002 in a structured way and registered their share in the housing finance system. The majority of commercial banks' loans has been or is being extended to middle and high income group, particularly in major cities.

The total housing finance portfolio reported by banks and development finance institutions (DFIs) was Rs. 88.2 billion (US\$1.10 billion) as at December 31, 2008 witnessing a growth of 59% over the last three years. However, the mortgage debt to GDP ratio is less than even 1% as compared to 5% in India, 18% in Malaysia and 15% in China. The total number of borrowers at the end of December 2008 just exceeds 123,000. In absolute numbers, the HBFC accounts for more than 75% of these borrowers, due to its wider customer base; but, in terms of financing, as indicated earlier, the commercial banks hold the majority share in overall housing finance portfolio.

Despite the growing economic and social importance that development economists are attributing to housing finance, it remains largely underdeveloped in 16 Pakistan. Private mortgages remain small and unaffordable and are provided by only a limited number of depository institutions. However, it does give comfort that strategic measures to address key impediments and challenges have been initiated and a roadmap has been set for further direction.

2.3.4 Sri Lanka

Banking and non-banking institutions provide housing finance in Sri Lanka. There are three specialized housing banks in the country. Two of them are government-owned: the State

Mortgage and Investment Bank (SMIB) and the Housing Development Finance Corporation (HDFC). The only private sector housing finance institution is Housing Bank, a new entrant that was established in 2001. In addition, the National Savings Bank (NSB), which again is a government-owned entity, is a significant contributor to the housing finance market. These institutions are the main players in housing finance among the specialized banks. They account for a significant volume of the housing finance business in the country (Piyasiri, 2006).

Practically all the domestic commercial banks currently provide housing finance. All advertise and promote housing finance aggressively. Special housing product brands are available in the market. Among the foreign banks, and more recently, the Hong Kong and Shanghai Banking Corporation (HSBC) has become a very aggressive player in the market, with variable interest rate. These would fall into the category of specialized banks. Smaller volumes of housing finance are provided by rural development banks as well. A number of micro-finance institutions seem to be providing limited housing finance to the low-income segment of the population. Most of these institutions have the objective of uplifting the quality of life through income-generating activities. In that process, they find that one aspect of uplifting involves improving housing conditions as well. Another group that contributes to the housing sector is the finance companies. One of the key asset products of these institutions is real estate development. Most of these institutions specialize in land development only. However, a few have also been involved in construction as well.

Housing development lacks Government funding due to budgetary constraints. Consequently, activities of institutions such as the National Housing Development Authority are confined to recoveries only. Other state-owned institutions such as SMIB and HDFC depend on deposit mobilization and funds borrowed from the debt market for their mortgage market activities. In contrast, the NSB funds its housing finance operations by deploying 100% of its own mobilized funds. NSB's current strategy of enlarging its retail portfolio has helped its housing finance operations immensely. Most commercial banks deploy their own mobilized funds for housing finance operations (Piyasiri, 2006).

Housing finance has grown significantly in the last few years. Most commercial banks have housing finance in their product range. The estimated housing portfolio of commercial banks

stands at around Rs. 55-60 billion. The specialized banks, including three specialized housing banks, have an estimated portfolio of around Rs 25 billion. Rural development banks and a number of micro-finance institutions are also involved in housing finance. The total estimated housing finance portfolio in the country may be in the region of Rs 80-85 billion. A large variety of housing products/brands and competitive options are available in the market. However, rate volatility would always be a challenge and hurdle for sustained growth.

As per the 2001 survey, there were 4.7million housing units in the country. The Central Bank annual report of 2003 estimated the housing shortage in the country at 400,000 units. The report also stated that the shortage is expected to increase to 600,000 units by 2010. This means that the annual demand for new housing is not being met by new construction. In addition, the above shortfall is prior to the December 2004 tsunami. The housing need of the war-affected regions of the Northeast of the country is also acute. Moreover, analysis of the quality of housing reveals that significant upgrading of existing housing can be effected. Therefore, the need for new housing and for financing is very significant.

2.4 Policies and Practices of Real Estate Financing in Nepal

Generally, real estate business is considered as an unproductive and risky business. However, it has many backward and forward linkages with many other sectors in the economy and generates positive impacts, too. The real estate sector may contribute significantly in employment generation and in developing land and housing in the country. In addition, it may contribute through the consumption of building materials. Moreover, it is a sector associated with fulfillment of basic needs of people.

Therefore, the question is: how much emphasis should be given for the development and financing of this sector? What type of policies should be devised for the optimum development and financing of this sector? How can the housing and real estate finance be supplied in proper way? What level of financing is called risky? Thus, for maintaining sustainable real estate investment, trading off between too much and too less real estate financing should be the focal issue while designing a policy prescription. This chapter briefly discusses the policies and practices of real estate financing in Nepal.

2.4.1 Policies and Institutional Arrangement for Real Estate Financing

The Government of Nepal has given certain priority for urban development and housing program in Kathmandu Valley through its various plans and programs. The Three Year Plan has set clear objectives, strategies and policies for housing and urban development, the most relevant ones being the following:

-) Implementation of national building code will be made obligatory.
-) Technicians will be produced in order to construct qualitative, less costly and safe buildings.
-) Updated and effective regulatory provisions for the construction of multi-storey building in the urban areas will be made.
-) Satellite cities will be developed around the capital city.

Likewise, the Budget Speech for the Fiscal Year 2010/11 has mentioned about developing infrastructures through land integration in Chobhar-Satungal part and demolishing illegally built houses and sheds in the river banks of Kathmandu valley. In addition, it has stated about identifying and providing proper housing facilities to real landless communities. Similarly, the Budget Speech for the Fiscal Year 2010/11 has focused attention for the revision and implementation of the “National Building Code” in order to manage and facilitate modern amenities to address increasingly unmanaged urbanization and housings in Kathmandu Valley. In Nepal, the majority of real estate builders and developers are working as sole proprietorships or partnerships business with limited capital base. They have poor corporate governance and fragile structures. This is creating various challenges for the proper growth and advancement of the sector. Lack of regulation, organizational structure and professionalism has led to the illegal construction process with unreliable building permits and use of substandard materials in construction. In addition, poor legal framework cannot cater to the interest of all the stakeholders in the sector. Nevertheless, the private sector is playing an active role for the development of housing and real estate sector. Professional real estate developers have mobilized their scarce financial resources and even borrowed from banks and financial institutions to invest in this sector.

Housing supply in Kathmandu has been taking place almost entirely with private sector initiation and through owner-builder process, financed mainly from personal savings, sale of

family assets such as land and jewelry, family loans, and to some extent, provident-fund loans. In addition to the above sources, the financing is also supported by loans from employer institution and bank loans. Family income compared to the price of land and house is quite low. It takes five to ten years, on an average, for low-income families to save to buy a plot of land and then almost as many years more to build a house. It is common to build low- and middle-income housing incrementally (Mathema, 1999).

Another interesting story can be noticed in the construction of house in the Kathmandu Valley. Virtually all the houses are constructed on prototype manner, one story at a time, with provisions to add floors later². Mostly, housing facility is acquired by different means including personal and family loan either from formal or from informal sector. This is basically due to the high cost of housing facility and lower level of income and saving. It takes quite a long time to repay the loan for majority of the people. However, the case is quite different for professional real estate developers, builders and real estate brokers.

Nowadays, different private real estate developers and housing companies are involved in construction of low-price housing, apartments and commercial complex. They usually enter into the agreements with banks and financial institutions for such financing.

The banks and financial institutions licensed by the NRB can lend in real estate sector (within a specified limit). The bank has issued directive to regulate the lending however, without closing the window of real estate financing. In addition, Employees' Provident Fund provides housing loans to its members (depositors). Another vista of financing of the real estate sector is from the perspective of various saving and credit cooperatives.

2.4.2 NRB's Regulation on Real Estate Financing

The financial and economic instability that followed the plunge in asset prices prompted central banks to revisit their policy responses. Central bankers generally have two options when faced with a surge in asset prices: they can either be proactive or reactive. To be proactive would be to lean against the wind, that is, to tighten monetary policy during the boom phase. The reactive policy would be to mitigate the consequences of an expected or an actual asset price bust (Laquindanum, 2010).

The NRB is fully cognizant of all issues and constraints of real estate sector. It has been working scrupulously to establish a dedicated infrastructure and institutional mechanism along with some deliberate initiatives to strengthen the real estate sector.

The NRB has been conducting research/analysis on the existing status of regulatory and policy frameworks. It has designed and implemented regulation to address the burning issue of housing and real estate sector. The following exhibit is designed to describe the major directives related to the real estate sector issued by the NRB along with their key features.

Table 2.2
Directives Related to Real Estate Sector

Directives/Date	Key Features
Unified Directives, 3/067 2066-09-02 (17-12-2009)	<ul style="list-style-type: none"> <li data-bbox="919 884 1442 1094">) Loan against the collaterals of real estate or housing/land should not exceed the 60% of fair market value of the collateral <li data-bbox="919 1094 1442 1367">) No banks and financial institutions should exceed 25% and 40% of total loans on real estate and real estate and residential housing loans respectively <li data-bbox="919 1367 1442 1640">) The real estate loans and real estate and residential housing loans should be brought down to following proportion of total loan within the stipulated time frame: <li data-bbox="919 1640 1442 1877">) Real Estate Loan: 15% by the end of FY 2068 and 10% by the end of FY 2069

	<ul style="list-style-type: none">) Real Estate Loan and Residential Housing loan: 30% by the end of FY 2068 and 25% by the end of FY 2069) Borrowers can restructure/reschedule the real estate loan upto one year if they have paid 25% of the principal and interest.) If the real estate/residential and housing loans are not brought within the limit in stipulated time, the amount exceeded should be given the risk weight of 150%.
<p>Directive 5/067/68, Amendment 2067/06/05 (21-09-2010)</p>	<ul style="list-style-type: none">) Residential loan against the of house/land should not exceed the two-third of fair market value of the collateral) Reclassification of real estate loan into: 1) residential housing loan, 2) commercial complex and residential apartment construction, 3) trading complex already built and which have begun earning and 4) other real estate loan. The real estate loans should be brought down to following proportion of total loan within the stipulated time frame: Total of categories 1), 2) and 3) : 30%

	<p>and 25% by the end of FY 2068 and FY 2069 respectively</p> <p>Other Real Estate Loan: 15% and 10% by the end of FY 2068 and FY 2069 respectively.</p> <p>Totals of 1), 2), 3) and 4): 30% and 25% by the end of FY 2068 and FY 2069 respectively.</p>
<p>Directive 21/067/68, Amendment 2067/12/04 (18-03-2010)</p>	<p>) Borrowers can restructure/reschedule the real estate loan up to one year only if they have paid due interest.</p> <p>) Relaxation of real estate loan definition so that the personal home loan of less than Rs 6 million may not be included in the real estate loan. The home loan can be provided by only one bank or financial institutions to one family only once.</p>

In fact, corrections were mostly undertaken at the time when housing demand was robust, speculation was excess and government regulation was weak and fragmented. The unprecedented rise in the price of housing and land has posed several questions in terms of adversely affecting macroeconomic stability. The central bank has initiated several efforts to curb down unhealthy practices in real estate activities through the regulatory framework for commercial banks and financial institutions to manage concentration risk and prudently match maturity profile of their assets and liabilities.

2.4.3 Product-wise Loan Classification of Commercial Banks

The loan portfolio of banks and financial institutions of Nepal signifies that real estate financing is increasing over the period. The product-wise loan classification of commercial bank is presented in Table 3.1 which summarizes the credit outstanding in Real Estate Loan, Personal Residential Home Loan and Total Loan and Advances of commercial banks.

Table 2.3
Product-wise Loan Classification of Commercial Banks

Particulars	July 2009	Jan 2010	July 2010	Oct 2010	Jan 2010*
Real Estate Loan	47,415.5	64,605	61,954.1	59,820	60,352
Personal Residential Home Loan	29,061.6	34,735	35,208.1	39,127	38,741
All other Loans	325,450.4	369,778	369,945.0	390,567	411,048
Total Loan * Personal Home loan represents the figure of Personal Residential Home Loan. Source: Bank and Financial Statistics, No. 53 and 54, NRB	401,927.5	469,118	467,107.2	489,514	510,142
Real Estate Loan on Total (%)	11.8	13.8	13.3	12.2	11.8
Personal Residential Home Loan on Total Loan and Advances (%)	7.2	7.4	7.5	8.0	7.6
Real Estate & Personal Residential Home Loan on Total Loan and Advances (%)	19.0	21.2	20.8	20.2	19.4

* *Personal Home loan represents the figure of Personal Residential Home Loan.*

Source: Bank and Financial Statistics, No. 53 and 54, NRB

Table 2.3 clearly depicts the distribution of real estate and personal residential home loan of commercial banks. In mid-July 2009, the real estate loan and personal residential home loan formed 11.8 percent and 7.2 percent share of the total loan respectively. In July 2010, the respective share of both the loans has slightly increased to 13.3 percent and 7.5 percent respectively. However, in January 2011, the share of above-mentioned loans exhibited

slackness and declined to 11.8 percent and 7.6 percent respectively. The share of real estate loan on total loan and advances increased to 21.2 percent in January compared to 19.0 percent in July 2009. It declined to 20.8 percent in July 2010 and 19.4 percent in January 2011.

In mid-July 2010 total real estate loan increased by 27.0 percent compared to the previous year whereas the real estate loan and personal residential home loan increased by 30.7 percent and 21.1 percent respectively.

Table 2.4
Real Estate and Personal Home Loan of BFIs
As at mid-April 2011

S.No	Particulars	Real Estate Loan (1)	Personal Home Loan (2)	Total (1+2)	Share in Real Estate Loan (%)	Share In total Personal Res. Home Loan %
1	Finance Companies	18,914.02	6,644.97	25,558.99	18.3	17.8
2	Development Banks	13,424.62	4,653.83	18,078.45	13.0	12.5
3	Commercial Banks	71,084.20	26,054.80	97,139.00	68.7	69.8
	Total	103,422.84	37,353.60	140,776.44	100.00	100.00

As illustrated in Table 2.4, the share of finance companies, development banks and commercial banks in personal residential home loan stood at 17.8%, 12.5% and 69.8 percent respectively in total. The majority of share in real estate loan and personal home loan is occupied by commercial banks which is natural. There is a minor difference in the distribution of the loans in real estate sector.

2.4.4 Economic Contribution of Real Estate Sector

Nepal is considered as a remittance based economy. Millions of Nepalese youths are going overseas for employment. They are sending significant amount of remittances for the livelihood of their families and relatives in the country. The ratio of workers' remittance to GDP has been about 20.0 percent, on average during the last three years. It is remarkable that such a big amount is coming from a single sector and most of it is spent on imported goods and real estate purchases. Due to lack of the proper and secure investment opportunities, people are spending their hard-earned income from abroad in unproductive sector. Construction sub-sector has recorded a satisfactory growth rate in the last five years averaging 4.5 percent while contributing 6.7 percent to the GDP. The loan disbursement of the banks and financial institutions in real estate and housing sector might have contributed for the development of this sector (Economic Survey 2009/10).⁴

2.4.5 Review of Related Studies

2.4.5.1 Review of Journals & Articles

Uttam Maharjan (2011) in his article titled "Real Estate and Housing Business: Now in the Doldrums" has mentioned that the real estate and housing business has been in the doldrums for around a year. The business has met with this fate since Nepal Rastra Bank issued stringent directives on this business last year in order to stop artificial skyrocketing prices of land and buildings. As per the directives, housing and real estate loans have to be restricted to 30 per cent of the total portfolio by the end of this fiscal year and to 25 per cent by the end of the next fiscal year.

Bank financing is a driving force behind housing and real estate transactions. In a country like Nepal where majority of the people are living a hardscrabble life, there are very few people who can afford a house. For such people, bank financing has become an easy means of scraping together funds required for building or purchasing a house. Real estate businessmen also rely on bank financing to carry on their business.

With the directives in force, banks are unable to make adequate investments in housing and realty sectors so much so that some banks are finding it arduous to bring their housing and real estate loans to the level as required by the directives. Furthermore, a hike in interest rates has

made housing and real estate loans - and for that matter other loans as well - costly, making it difficult even for the existing loan clients to repay their loans. What's more, a housing or realty loan can be renewed for one year after 25 per cent of the loan - together with all the outstanding interest - has been repaid, creating an additional financial burden on the loan clients.

Besides, there are other bottlenecks that are acting as a stumbling block to the growth of housing and real-estate transactions. Income sources need to be declared for the purchase of land costing Rs. 2.5 million or above and for the purchase of a house costing Rs. 5 million or above. There is a compulsion for people to reveal sources as per the Anti-Money Laundering Act-2064, whenever an amount of Rs. 1 million or above is deposited with a bank. The liquidity crisis is still persisting in the banking sector. Most of the banks have stopped disbursing new loans for lack of liquidity. There is no satisfactory deposit mobilisation. At present, the credit-deposit ratio stands at 89 per cent, which should not, as per the NRB directive, exceed 80 per cent.

One of the reasons for this sorry state of affairs is sluggish government spending due to a delay in the promulgation of the budget. There is a fund of Rs. 28 billion in the government account. With imports outstripping exports and due to other factors, the balance of payments (BOP) deficit now stands at Rs. 5.03 billion. The other reason is the provision for seeking sources while making a deposit of Rs. one million or above with a bank, creating a kind of psychological fear among the people and resulting in the informal banking sector flourishing or diversion of money to India. This has resulted in deposit rates increasing and a corresponding hike in loan rates. In consequence, most people are not in a position to afford bank loans.

The government has also introduced a capital gains tax on housing transactions of Rs. five million or above. This provision may also be considered a hindrance to housing transactions. The main target of revenue mobilisation of the government seems to be through taxation. At present, every remuneration is taxable, at least at one per cent of the total remuneration. The government has also hiked property tax.

The government is fully aware of the fact that people resort to tax evasion by undervaluing their property. To discourage such undervaluation, the government has made provision for buying the property itself if it deems it highly undervalued. This measure is not, however, viable because people have rights to sell their property at whatever prices they like. Government interference in such cases is highly undesirable.

Government valuation of property is far from its actual, or market, value. If the government thinks that a property is undervalued and tax evasion is suspected, then it should value property realistically so that tax can be levied as per the government valuation rather than as per the selling price. To encourage the growth of housing transactions, personal housing loans should be segregated from real estate and commercial housing loans because it is the common people, not businessmen, that take loans to build or purchase houses. Today, the prices of land and buildings are high. As such, the existing provision for seeking sources should be relaxed. Sources should not be sought for land transactions up to Rs. 10 million and for land and building transactions up to Rs. 20 million.

To stimulate deposit mobilisation, the provision for seeking sources for deposits of Rs. 3 million or above should be in place. The capital gains tax should be scrapped. Steps need to be taken to avert the current liquidity crunch. Bank rates need to be lowered to an affordable level (which is possible when the liquidity situation eases). The current provision for renewing housing and real estate loans after repayment of 25 per cent of the principal and all the outstanding interest should be annulled. Renewal of such loans should be allowed on a par with other loans.

Raju Sitaula (2011) in his article titled “Banking on Real Estate” mentions that Banks in Nepal seem to be thriving. According to Nepal Rastra Bank, Nepali commercial banks hold close to Rs 470 billion in deposits, but for banks to be profitable they have to put this deposit to work. Given the poor business climate and soaring property prices, it is a fair guess? This cash is feeding the real estate bubble. Such a bubble driven by excess credit fueled liquidity is exactly what brought many US banks to their knees, and there is a good lesson there for us. As property prices went up, banks in the US found increasing their real estate loan portfolio an easy way to boost earnings. They not only kept loans in their own balance sheet, but packaged

them into securities which were sold to investors worldwide, further increasing the demand for mortgage loans. Borrowers were approved for loans they were not capable of paying and many jumped on the bandwagon assuming that real estate prices could only go up.

What initially started as a problem in the subprime loans or loans made to risky borrowers, has spread to prime loans as decreasing real estate prices and increasing unemployment rate are putting even credit worthy borrowers at risk. As a result, banks are now stuck with hundreds of billions of dollars in real estate loans, some of which are practically worthless, and are thus forced to book billions of dollars in losses. The massive loans are threatening the solvency of some US banks. The FDIC has seized more than 21 failing banks so far in 2009 alone.

We are inside a real estate bubble in Nepal, and this bubble could burst. Among other things, the excess cash available to drive prices higher may not be there in the future. The global economic slowdown is already impacting on the remittance flow into Nepal which will reduce the liquidity in the banking sector and the money chasing real estate assets.

When the bubble bursts, not only will many Nepalis feel much poorer from reduced property prices, but their deposits in banks could also be at risk if banks that are overexposed to real estate lending face defaults, threatening their ability to meet obligations to depositors. The margin of error for Nepali financial institutions, and the public, is very small. Unlike most other countries, there is no established deposit insurance program in Nepal and it is questionable that Nepal Rastra Bank has the ability to manage a run on the banks.

Outstanding loans of commercial banks to the real estate sector grew at a staggering rate to Rs 17.9 billion in February from Rs 6.6 billion just a year earlier. The questions to ask the banks are: what percentage of outstanding loans is real estate related, including both direct and indirect loans where real estate asset is kept as collateral? How will the real estate price reduction affect the performance and recovery of these loans? Have the banks done a sensitivity test for the worst case scenario and are they adequately capitalised if that scenario materialises?

The government and Nepal Rastra Bank should also look into the feasibility of instituting a deposit insurance program up to a certain threshold. Such a program can be funded from the premium paid by the deposit-taking institutions and the premium should be based on the risk assessment of each participating institution. It is not too late for Nepal, but it is time to ask tough questions to the banks and the regulator and focus on risk management so that when this real estate bubble ultimately bursts, it doesn't take the banking sector down with it.

2.4.5.2 Review of Dissertations

Krishna Sunuwar (2010) in his dissertation “Real Estate in Nepal and NRB Cap” has mentioned that the main reason behind the rapid growth in real estate sector was just because of the massive investment facility provided from financial institutions. We saw that more investment in realty market had made very bad effect in the US economy. Realizing those facts, since last year government had started eyeing on investment in realty market. As per the Nepal Rastra Bank report, because of the huge investment in unproductive sector i.e. realty market, we had to face liquidity problem in the market last year and the situation still has not been recovered. In a bid to correct the overheated realty market, Nepal Rastra Bank (NRB) imposed a cap on the exposure of banks and financial institutions to housing and real estate loans, asking them to limit such exposure to 25 percent of their total investment portfolio.

The new directive requires the banks not to issue loans of more than 60 percent of fair market value of the collateral/project. As for the real estate sector (which does not include the housing sector) the central bank has asked the lending banks to reduce exposure to 15 percent of total loan portfolio by the end of next fiscal year and to 10 percent by the end of fiscal year 2012/13. In case banks and financial institutions fail to comply, the central bank has said they will need to provision for the excess amount (above the cap), calculating it on the basis of 150 percent risk weightage.

Acharya (2009) had concluded a study on “Land management for sustainable real estate development in Nepal” with an objective to assess the current situation of real estate business in Nepal on the absence of proper land management. He mentions on his dissertation that It is only possible through the management of land and natural resources in the framework of sustainable development strategy by strengthening rural development, promotion of land

markets, food security, rural-urban balance and disaster mitigation. It should be kept in mind that the use of land and natural wealth should be based on the principle of ecological sustainability and without unnecessarily harming the environment.

There is an increasing recognition of Geo-information science and land administration in government as well as in society. Therefore we cannot avoid talking about real estate markets for social and economic development of the people. Property markets will lack the confidence without accurate cadastral survey and effective land administration which will only lead to sustainable land management. Therefore it requires a high degree of precision in adjudication and boundary measurements.

Main conclusion of his study was that the land market is being flourished because the financial institutions are using land as collateral for loans and are making economic focuses. Due to unskilled brokers and lack of spatial planning people are suffering from land disputes. The unskilled or illiterate land developers are damaging good fertile agri-land for residential plots without any spatial planning and are making easy money. The provision of utility services in the planning area is very poor due to unscientific land development planning. Land administration seems weak because of the non-priority to improve them seriously. The emerging real estate industry is not functioning in a systematic way so it has to be streamlined as priority. Land development is progressing in urban areas but not in rural areas that has created a long gap between rural and urban life.

Manandhar (2010) in his study “Impact of NRB Policy in Real Estate Business” has mentioned that Main purpose of the monetary policy and directive issued by NRB to fix a ceiling on real estate and housing lending is to prevent possible financial systemic failure. NRB is also mulling to hike up interest rates in these sectors. As a result most of the banks have stopped loans for both developers and consumers. Those financial institutions that are providing loans have imposed higher interest rates making it unaffordable for the general public to purchase a new house. Thus, this policy is directly affecting to low and middle class people having normal income.

Meanwhile, controversies are rising over NRB's directive to forestall up-and-coming systemic failure of the financial system. Some of the economists believe that NRB took a hasty decision and it will directly affect the growing housing and real estate sector in the short run and the whole banking and financial system eventually.

Our economy has been experiencing low growth. The incentives to make business investments are very limited in the other sector as the economies of scale do not work in an entrepreneur's favor due to the limited size of our economy and current political situation. So without recognizing other alternative productive sector for investment, this policy may further worsen our economy. Whatever may be the arguments, it is apparent that the real estate and housing bubble will create problems in the economy in the future. The main conclusion of his study was as follows:

1. Policy has led the financial institution to increase the interest rate which has made unaffordable for the general public to purchase a new house.
2. Overall portfolio of some financial institution are in decreasing trend
3. It has affected the real estate business in a short run and it can affect the whole banking system in a long run when bank, because it may increase Non performing loan of the banks
4. without recognizing other alternative productive sector for investment, this policy may further worsen our economy
5. As a result, buying / selling of the real estate dropped dramatically
6. The interest rate has increased almost two-fold from 10 % to 18% pushing up the cost of homes and discouraging sales.

CHAPTER-III

RESEARCH METHODOLOGY

Research methodology is a way to systematically solve the research problem. It may be understood as a science of studying how research is done scientifically. It is necessary for the researcher to know not only the research methods but also the methodology. When we talk about the research methodology we not only talk of research methods but also consider the logic behind the methods we use in the context of our research study and explain why we are using a particular method or technique and why we are not using others so that research results are capable of being evaluated either by the researcher himself or by others. The study of research methodology gives the student the necessary training in gathering materials and arranging them, participating in the field work which required, and also training in techniques for collection of data appropriate to particular problems, in the use of statistics, questionnaires and controlled experimentation and in recording evidence, sorting it out and interpreting it. (Kothari, "Research Methodology", pp 10-13) This chapter describes the methodology employed in this study. Research methodology is a way to systematically solve the research problem. In other words research methodology describes the methods processes applied in the entire aspect of the study. This chapter describes research design, population, sampling procedure, and sources of data and analysis of data.

3.1 Research design

Present study follows the descriptive as well as analytical statistics of the analysis to meet the stated objectives of the study. 'Descriptive studies are primarily concerned to find out 'What is'. The secondary data were analyzed from the data collected from the share department of the related banks. Few financial statements of selected commercial banks were tabulated using spreadsheet.

3.2 Sources of data

The research is based on primary as well as secondary source of data. For research purpose, published financial statements (i.e. Annual report) of concerned banks were collected. Similarly, financial statement of selected commercial banks and various markets related

information were collected and tabulated in spreadsheet. Such secondary information was gathered from the share department of the concerned banks. Carefully designed research instrument (questionnaire) used for primary data analysis. The researcher has carefully designed questionnaire by considering various influencing factor of industry environment, management quality. The factors derived from previous research findings on related area are to support risk assets management. Basic sources of primary information were employees of concerned banks. In addition, an answer on certain queries made to staffs of concerned organization personal requires and discussions were also being conducted for clarification and verification of collected data and for recommendation.

3.3 Population and Sample of survey design

A small portion chosen from the population for studying its properties is called a sample and the number of units in the sample is known as the sample size. The method of selecting for study a small portion of the population to draw conclusion about characteristics of the population is known as sampling. Sampling may be defined as the selection of part of the population on the basis of which a judgment or inference about the universe is made. (Sharma and Chaudhary(2058), “Statistical Methods”, pp 171-173)

Here only 2 sample commercial banks are taken out of 32 commercial banks. For selecting the samples, non-random sampling method is used here among different methods. The samples are taken only from commercial banks. Organization under study is as follows, whose general introduction and major objectives are presented in chapter one. The sample organizations are as follows:

-) NABIL Bank Ltd.
-) Himalayan Bank Ltd.

3.4 Primary data collection techniques

Individual data sheet was used to gather information about selected characteristics of the respondents. Selection of the items for individual data sheet was primarily based on earlier international researches concept on the related subject and the previous research findings. The instrument has sixteen items relating to industrial environment and rewiring seven items are related to management quality. Few demographic variables such as gender position, age, major

profession and experience in work in an organization were also designed and included in the instrument. The demographic variables were designed in nominal scale.

3.5 Primary data collection procedure

Convenient sampling technique was followed to gather the opinion or characteristics of employees of the concerned bank. Questionnaire were administered and returned in four-five days. In many situations, the researcher asked the respondents to give opinions of the questions and ticked on replied answers to administer the questionnaire. Researcher personally visited the respondents. The last hour of the 5 day was used to request the respondents to fill up the questionnaire. In most of the cases, meaning of the items and instruments were described to the respondents, which helped them to give fair opinion. total no. of respondents were 40.

3.6 Statistical tools

Statistics is a body of methods of obtaining and analyzing data in order to base decision on them. It is a branch of scientific method used in dealing with phenomena that can be described numerically either by counts or by measurement. Thus the word statistics refer it a method of dealing with quantities information. Webster defined statistics as ‘the classified facts represented by the condition of the people in state especially those facts which can be stated in numbers or in tables of number or in any tabular or classified arrangement’.

3.7 Regression and Correlation

Regression and Correlation Analysis are the techniques of studying how the variations in one series are related to the variation in another series. Measurement of degree of relationship between two or more variables is called correlation analysis and using the relationship between a known variable and an unknown variable to estimate the unknown one is termed as regression analysis. Thus, correlation measures the degree of relationship between the variables while regression analysis shows how the variables are related. Regression and Correlation analysis thus determines the nature and strength of the relationship between two variables. (*Sharma and Chaudhary*, “Statistical Methods”, Pg 405.)

$$r = \frac{N \sum xy - \sum x \sum y}{\sqrt{N \sum x^2 - (\sum x)^2} \sqrt{N \sum y^2 - (\sum y)^2}}$$

CHAPTER – IV

DATA PRESENTATION AND ANALYSIS

4.1 Introduction

The present study has focused on various aspects of real estate sector. For the analysis purpose the secondary data collected from the sample banks Nabil Bank Ltd. and Himalayan Bank Ltd. are taken. Different fundamentals of both the bank as well as the ratio have been calculated. For the purpose of primary data analysis a questionnaire survey was conducted and information received from the survey has been duly processed and discussed in various sections of this chapter concentrating mainly on the financing aspect of real estate sector.

In recent years, land and housing development and construction business is increasing rapidly in Kathmandu valley. The tendency is fueled by the migration from other parts of the country (rural or urban) to Kathmandu valley. This study is designed to present the case study of real estate financing in Kathmandu Valley.

4.1.1 Financial Analysis

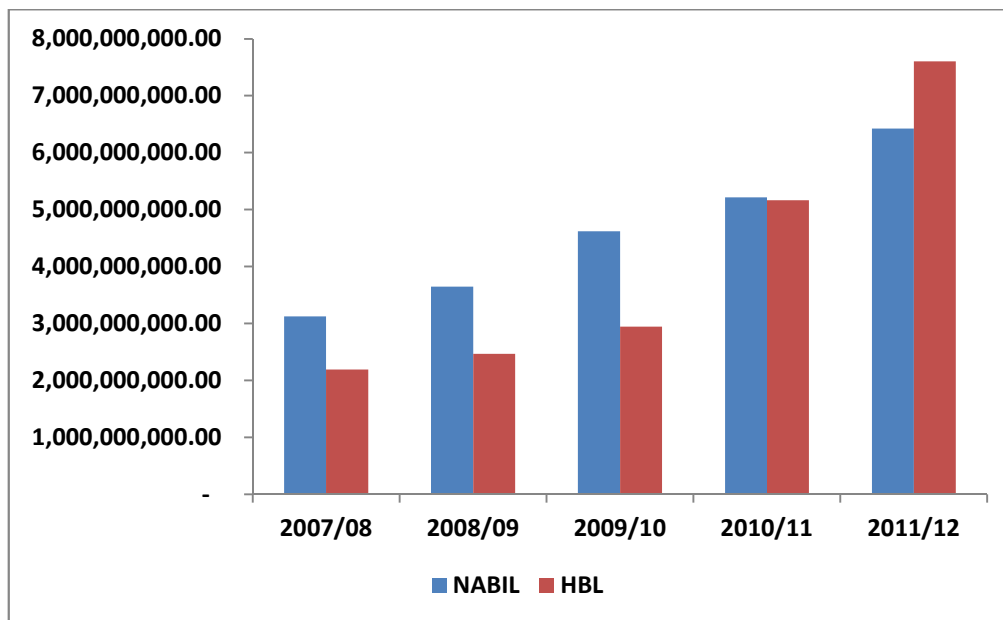
4.1.1.1 Amount of Real Estate Loan

The main focus of the research is to assess the amount of real estate loan, Nepalese financial institutions have liquidated. For this purpose the real estate loan of the sample banks for the study period has been studied. This real estate loan excludes the lending made on residential housing loans below Rs. 10 million.

Table 4.1
Amount of Real Estate Loan

Year	NABIL	HBL
2007/08	3,123,678,000.00	2,189,546,000.00
2008/09	3,645,500,000.00	2,467,568,000.00
2009/10	4,617,286,000.00	2,944,546,000.00
2010/11	5,215,573,000.00	5,163,351,000.00
2011/12	6,421,646,000.00	7,603,894,000.00

Figure 4.1
Amount of Real Estate Loan



Above table and figure shows the total amount of real estate loan provided by the banks under study throughout the study period. During the study period, real estate loan of both the banks was found to be continuously increasing. Amount wise, real estate loan of NABIL is more than HBL except in FY 2011/12. In FY 2010/11 the real estate loan of both the bank was found to be approximately equivalent. But in FY 2011/12 the loan amt. of HBL increased than of NABIL. It shows that the proportion of real estate loan in Nepalese financial institutions is increasing continuously despite the rules imposed by NRB recently. There is a steady growth in the amount of real estate loans.

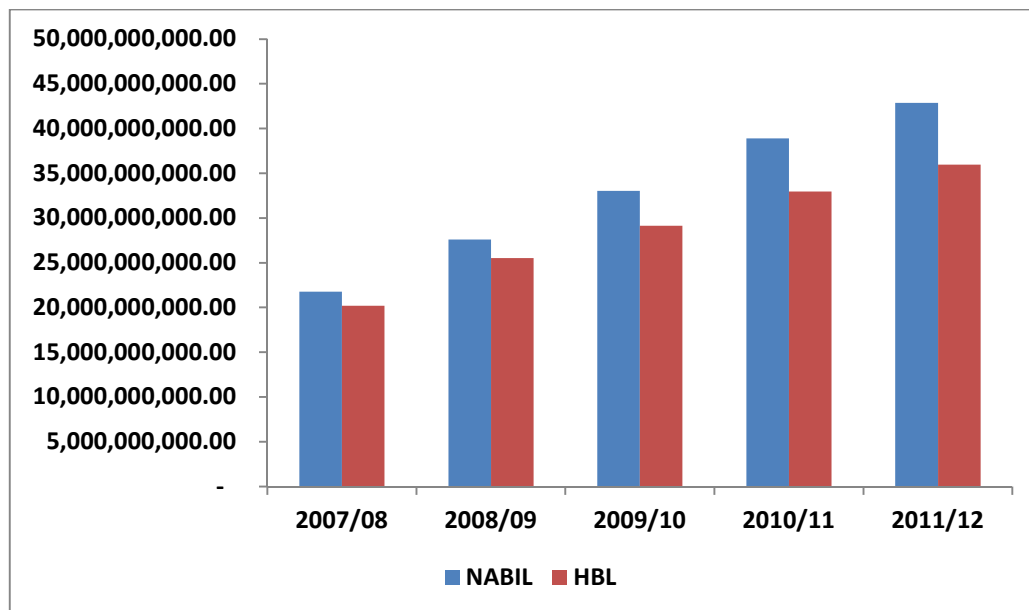
4.1.1.2 Total Lending Amount

The proportion of real estate loan of a financial institution can be studied better by comparing it with the total lending. Total lending or gross loan and advances of a commercial bank is composed of different type of loan products as like personal loan, real estate loan, housing loan, margin lending, hire purchase loan, deprived sector loan etc. The total loan and advances of the sample banks under study is as follows:

Table 4.2
Total Loan Amount

Year	NABIL	HBL
2007/08	21,769,771,000.00	20,179,613,000.00
2008/09	27,589,933,000.00	25,519,137,000.00
2009/10	33,030,969,000.00	29,123,755,000.00
2010/11	38,905,481,000.00	32,968,270,000.00
2011/12	42,867,768,000.00	35,968,473,000.00

Figure 4.2
Total Loan Amount



From the above table and figure it can be concluded that the total loan and advances of both the sample banks under study is increasing continuously throughout the study period. The total portfolio of NABIL is higher than the total portfolio of HBL throughout the study period. Therefore it can be concluded that Nepalese commercial banks are being able to increase their lending portfolio annually. The growth ratio of loan and advances of NABIL is higher than that of HBL.

4.1.1.3 Real Estate Loan to Total Loan

NRB has imposed several restrictions on real estate financing by the commercial banks. The following table depicts the proportion of total real estate loan in comparison with the total loan and advances.

Table 4.3
Real Estate Loan to Total Loan

Year	NABIL	HBL
2007/08	14.35	10.85
2008/09	13.21	9.67
2009/10	13.98	10.11
2010/11	13.41	15.66
2011/12	14.98	21.14

Figure 4.3
Real Estate Loan to Total Loan

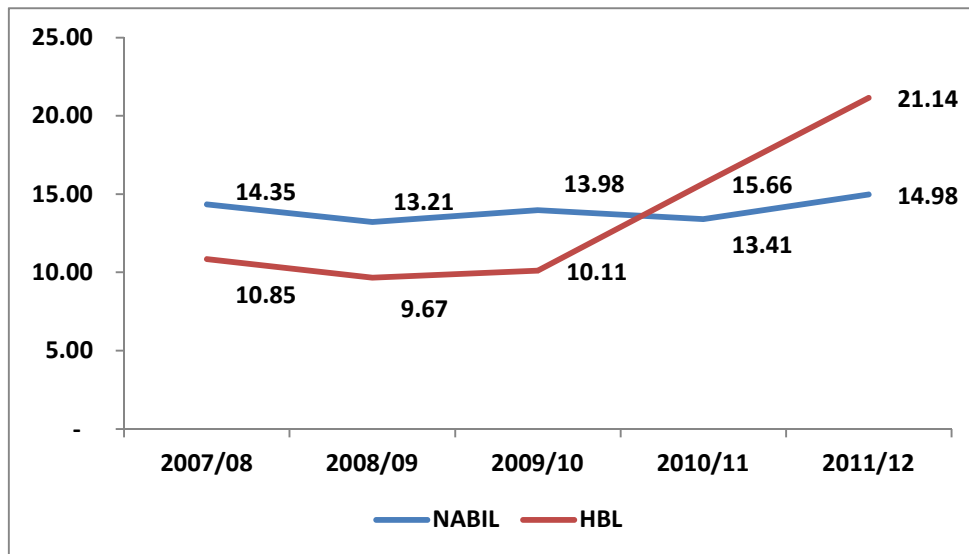


Table No. 4.3 shows the proportion of real estate lending among the total lending of the banks under study. The ratio of NABIL is somewhat constant during the study period but the same of HBL has been decreased in FY 2008/09 and then started to rise sharply. This shows that HBL is currently increasing its portfolio on real estate loan. while comparing the two sample banks under study the ratio was found to be higher in case of NABIL for the first three years of the

study period but the same has been changed in the last two years of study period and HBL has higher lending i.e. 15.66% and 21.14% in comparison with 13.41% and 14.98% of NABIL.

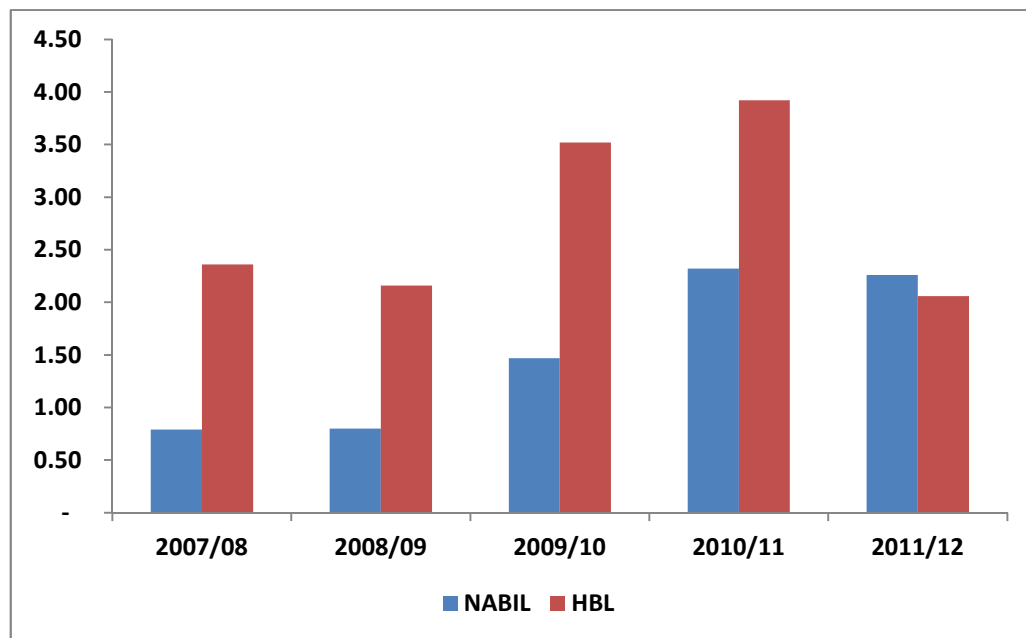
4.1.1.4 Non Performing Loan to Total Loan Ratio

It is imperative to investigate the quality of real estate loan and compare it with the general NPA level of banks and financial institutions. For this purpose the non performing loan to total loan ratio has been analyzed.

Table 4.4
Non Performing Loan to Total Loan Ratio

Year	NABIL	HBL
2007/08	0.79	2.36
2008/09	0.80	2.16
2009/10	1.47	3.52
2010/11	2.32	3.92
2011/12	2.26	2.06

Figure 4.4
Non Performing Loan to Total Loan Ratio



Above table and figure depicts the percentage of nonperforming loan to total loan. NRB has prescribed all the banks and FI's to maintain their non performing loan within the bracket of 5%. From the above table and figure it can be concluded that the NPL of both the banks under study is reasonable. Among the two banks, the NPL of HBL is higher than that of NABIL. Individually, the NPL level of NABIL is constantly increasing while the NPL of HBL is found to be fluctuating over the study period. The NPL of NABIL was found to be higher in FY 2010/11 i.e. 2.32% and the minimum was in FY 2007/08 i.e. 0.79%. In case of HBL the NPL was maximum in FY 2010/11 i.e. 3.92% and minimum in FY 2008/09 i.e. 2.16. From the above data it can be concluded that HBL should maintain its NPL level quite low.

4.1.1.5 Total Loan Loss Provision to Total NPL

Loan loss provision is used safeguard the bad loans of financial institutions. As per NRB directives every bank and financial institution must set aside a certain amount of fund to cover the all NPL of a company. If the total NPL of a company is Rs. 100 then bank financial institutions set aside more than Rs. 100 to overcome the possible losses in future. More the total loan loss provision more safe will be the company. A good bank and financial institution set aside a large amount of fund to overcome the future losses from NPL.

Table 4.5
Total Loan Loss Provision to Total NPL

Year	NABIL	HBL
2007/08	236.05	142.62
2008/09	181.96	128.49
2009/10	155.05	111.58
2010/11	102.18	105.74
2011/12	126.68	126.93

Figure 4.5

Total Loan Loss Provision to Total NPL

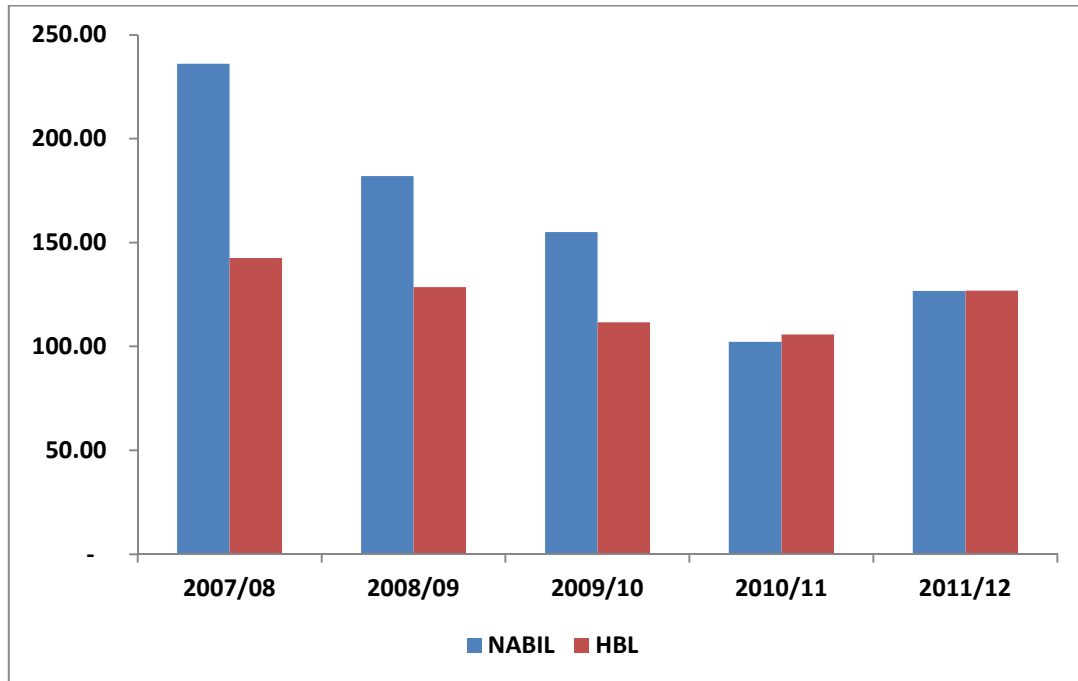


Table No. 4.5 shows the percentage of Total loan loss provision made by the sample banks under study throughout the study period. From the above table it can be depicted that NABIL has set aside more fund to provision the NPL than HBL. The amount of provision made by both the bank to safeguard the NPL is in decreasing trend for the first three FY but the same has been increasing for the last two fiscal years. Comparatively NABIL has kept more provision for NPL than HBL except in FY 2010/11.

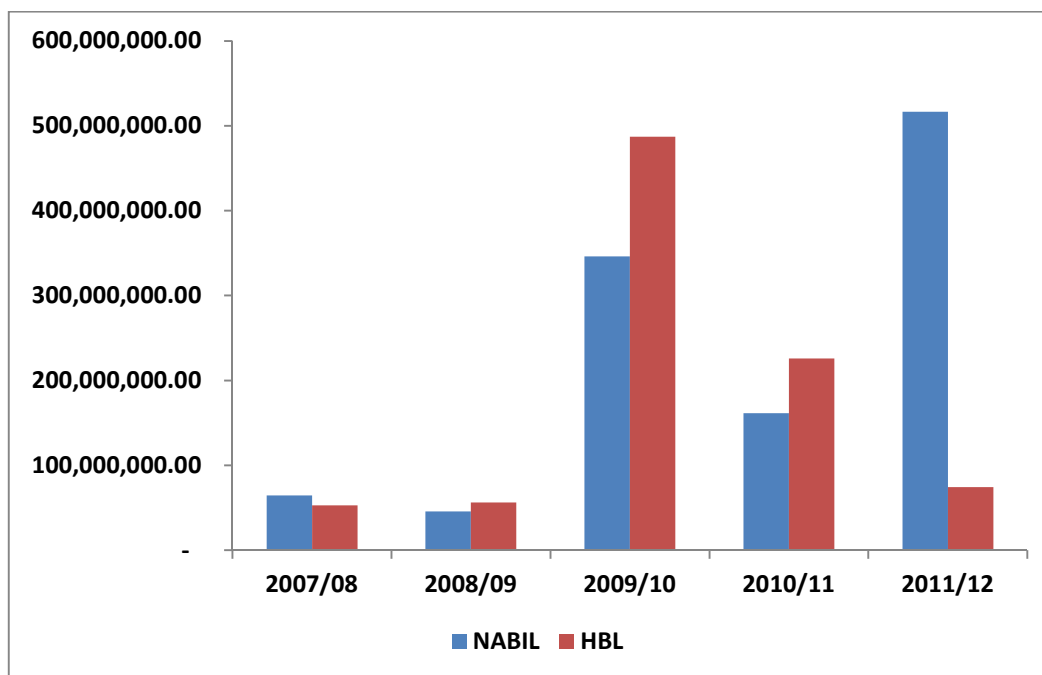
4.1.1.6 Provision for Possible Losses

Provision for possible losses is kept by the bank financial institutions to overcome the probable future losses. In case of any loan becomes default, the bank starts the recovery process and convert the mortgaged collateral as a Non Banking Assets. An amount equal to the value of Non Banking Assets is kept aside as a possible loss provision. When the Non Banking Assets is sold and certain amount is realized then that provision is written back. If nothing can be realized then the loan amount is written off.

Table 4.6
Provision for Possible Losses

Year	NABIL	HBL
2007/08	64,500,000.00	52,970,000.00
2008/09	45,722,000.00	56,303,000.00
2009/10	345,986,000.00	487,070,000.00
2010/11	161,528,000.00	226,031,000.00
2011/12	516,588,000.00	74,293,000.00

Figure 4.6
Provision for Possible Losses



Above table shows the amount of provision for possible losses set aside by both the sample banks under study throughout the study period. The amount set aside by both the NABIL and HBL is substantially high in the last three FY of the study period but the same is minimal in the beginning two FY. The trend of provision for possible losses is in fluctuating trend for both the banks. Comparatively NABIL has set aside more amount of provision than HBL during the study period.

4.1.1.7 Real Estate Loan to Total Deposits

Bank and financial institution's main source of lending is the deposit they collect from the general public. So it's important to study the proportion of real estate loan with the total deposits made by the bank.

Table 4.7
Real Estate Loan to Total Deposits

Year	NABIL	HBL
2007/08	9.79	6.86
2008/09	9.76	7.10
2009/10	9.95	7.82
2010/11	10.49	12.62
2011/12	11.67	15.93

Figure 4.7
Real Estate Loan to Total Deposits

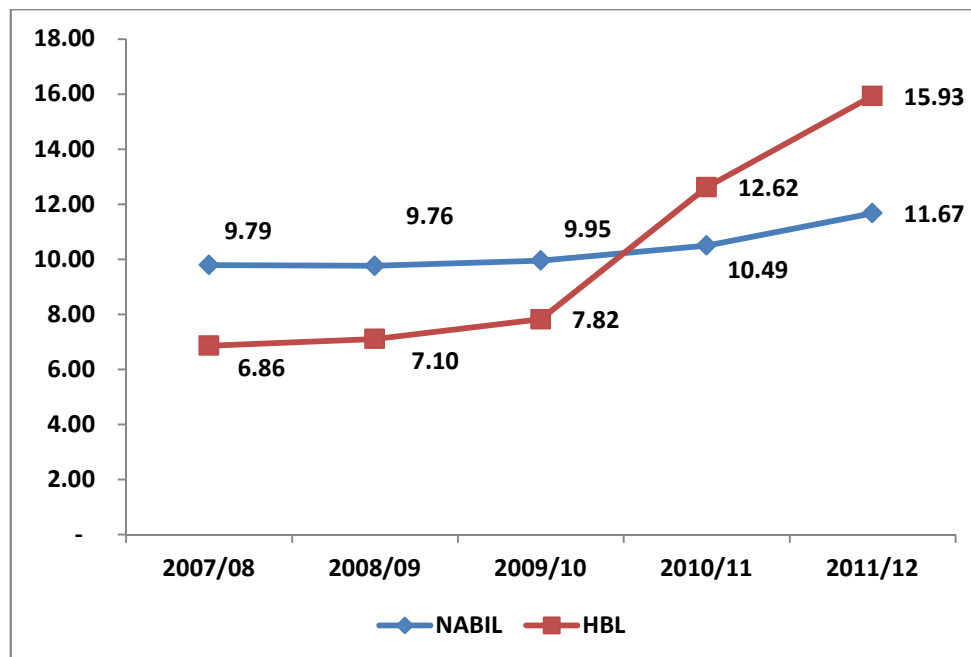


Table no. 4.7 shows the ratio of real estate loan to the total deposits made by both the sample banks under study during the study period. In this consequence from the above table and figure it's clear that the ratio of real estate loan to total deposits is somewhat constant in case of

NABIL but the same of HBL is in increasing trend. Therefore it can be concluded that HBL is utilizing more of its deposit in real estate loan. This ratio is maximum in case of both NABIL and HBL in FY 2011/12.

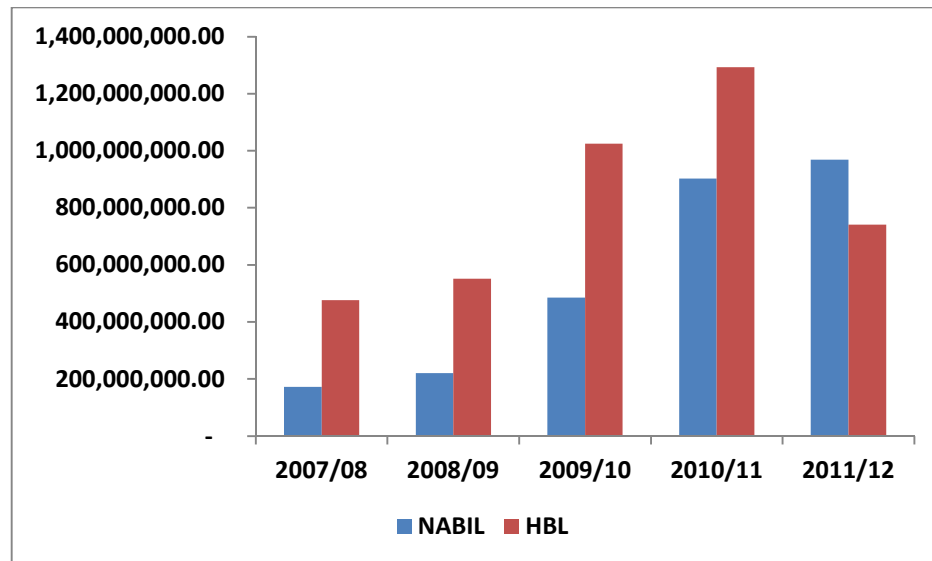
4.1.1.8 NPL of the Sample Banks

Quality of all the loans provided by a bank FI's is determined by the level of NPL of those bank FI's. So it's important to analyze the NPL level of the banks under study throughout the study period.

Table 4.8
NPL of the Sample Banks

Year	NABIL	HBL
2007/08	171,981,190.90	476,238,866.80
2008/09	220,719,464.00	551,213,359.20
2009/10	485,555,244.30	1,025,156,176.00
2010/11	902,607,159.20	1,292,356,184.00
2011/12	968,811,556.80	740,950,543.80

Figure 4.8
NPL of the Sample Banks



Above table No. 4.8 shows the level of NPL of both the sample banks under study throughout the study period. From the above table and figure it can be concluded that the level of NPL of

HBL is comparatively higher than the level of NABIL throughout the study period except FY 2011/12. The level of NPL of NABIL is continuously increasing throughout the study period. In case of HBL the amount is continuously increasing except in FY 2011/12. From the analysis it can be said that the NPL of NABIL is continuously increasing so its level should be maintained at time.

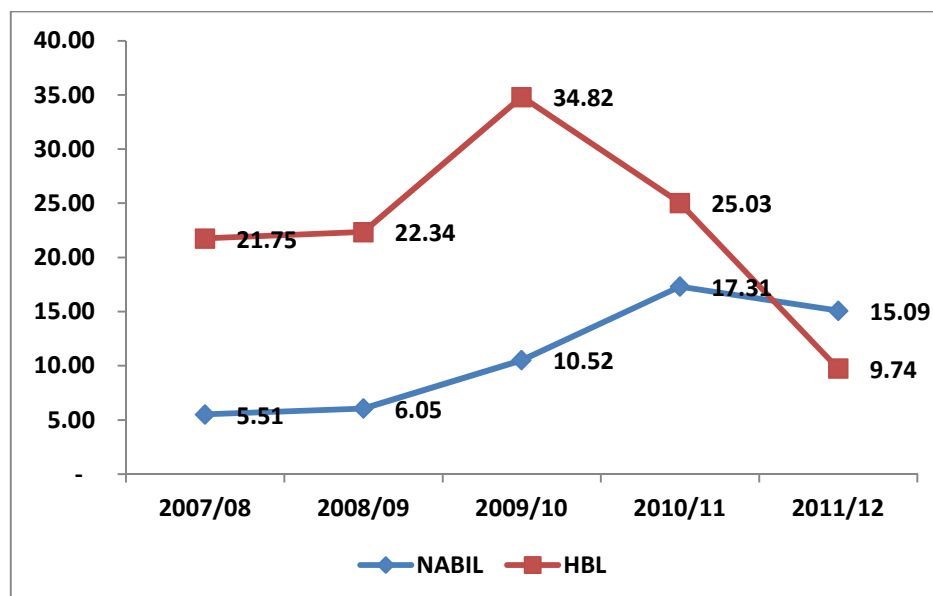
4.1.1.9 Total NPL to Real Estate Loan

The following table shows the proportion of NPL to the total real estate loan liquidated by the sample banks under study.

Table 4.9
Total NPL to Real Estate Loan

Year	NABIL	HBL
2007/08	5.51	21.75
2008/09	6.05	22.34
2009/10	10.52	34.82
2010/11	17.31	25.03
2011/12	15.09	9.74

Figure 4.9
Total NPL to Real Estate Loan



From the above table it can be concluded that the ratio of NPL to real estate loan of HBL is higher than that of NABIL bank except in FY 2011/12. The ratio for HBL is higher in FY 2009/10 whereas the lowest in FY 2011/12. In case of NABIL its maximum in FY 2010/11 whereas minimum in FY 2007/08.

4.2 Primary Data Analysis

A questionnaire with 10 questions related to real estate financing in Nepal were formulated and provided to fill it to 40 persons. The respondents were all from Kathmandu valley and related to real estate financing. Some of the respondents were professionals working in the bank financial institutions too. The data collected was analyzed and presented on the following part question wise.

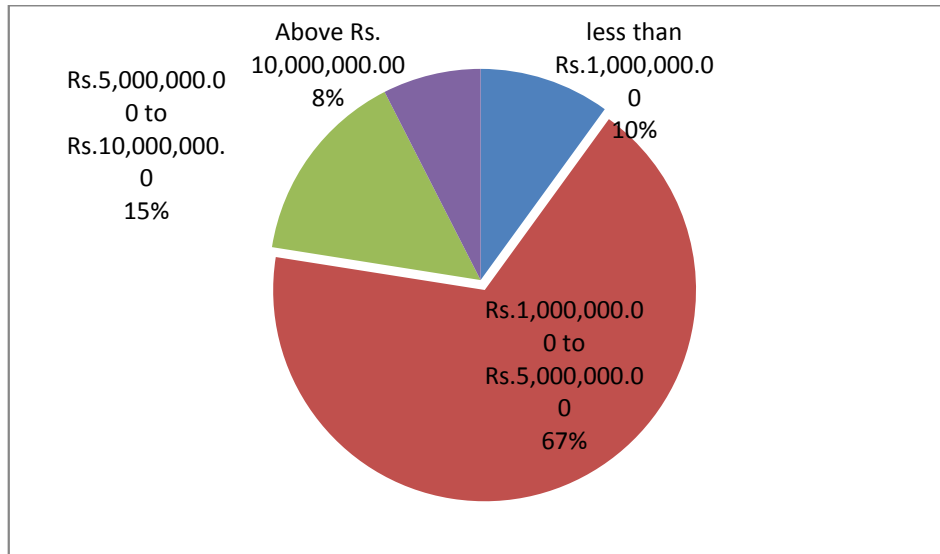
4.2.1 Amount of Loan

Respondents were asked to mention about the loan amount the respondents have taken from bank and financial institutions. This question was created to know amount the average loan amount maximum people are enjoying. The findings are summarized as follows:

Table 4.10
Amount of Loan

S.No.	Particulars	Respondents	Percentage
1	less than Rs.1,000,000.00	4	10
2	Rs.1,000,000.00 to Rs.5,000,000.00	27	67.5
3	Rs.5,000,000.00 to Rs.10,000,000.0	6	15
4	Above Rs. 10,000,000.00	3	7.5
	Total	40	100

Figure 4.10
Amount of Loan



From the above table and figure it can be concluded that majority of the respondents (67.5%) replied that their loan amount is in between 1 million to 5 million NRS. 15% of the respondents replied that they are enjoying a loan amount of NPR 5 million to 1 crore. only 3 of the respondents among 40 respondents replied that they are enjoying loan amount of more than NPR 1 crore. From the above analysis it can be said that majority of the respondents are enjoying loan amount in 1 million to 5 million.

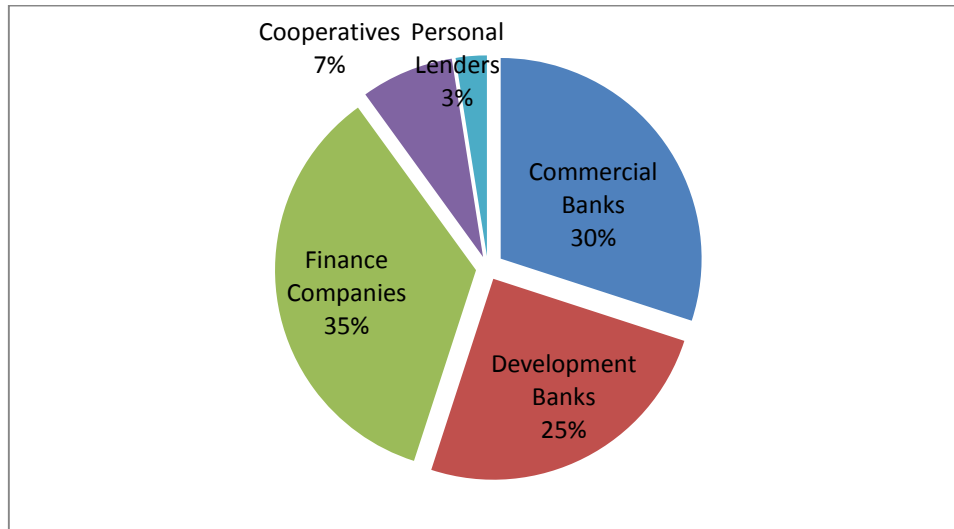
4.2.2 Sources of Lending

Respondents were asked to mention about the source of their loan. This question was created to know about the source of lending maximum people are enjoying. The findings are summarized as follows:

Table 4.11
Source of Lending

S.No.	Particulars	Respondents	Percentage
1	Commercial Banks	12	30
2	Development Banks	10	25
3	Finance Companies	14	35
4	Cooperatives	3	7.5
5	Personal Lenders	1	2.5
	Total	40	100

Figure 4.11
Source of Lending



From the above table it can be concluded that 30%, 25% and 35% of the respondents are enjoying loan facility from commercial banks, development banks and financial institutions respectively. 7% of respondents are enjoying loan facility from the cooperatives and 3% of the respondents are enjoying the loan facility from the personal lenders. From the above analysis it can be concluded that major customers are enjoying their loan facility from the organized sectors such as banks and financial institutions.

4.2.3 Types of Loan

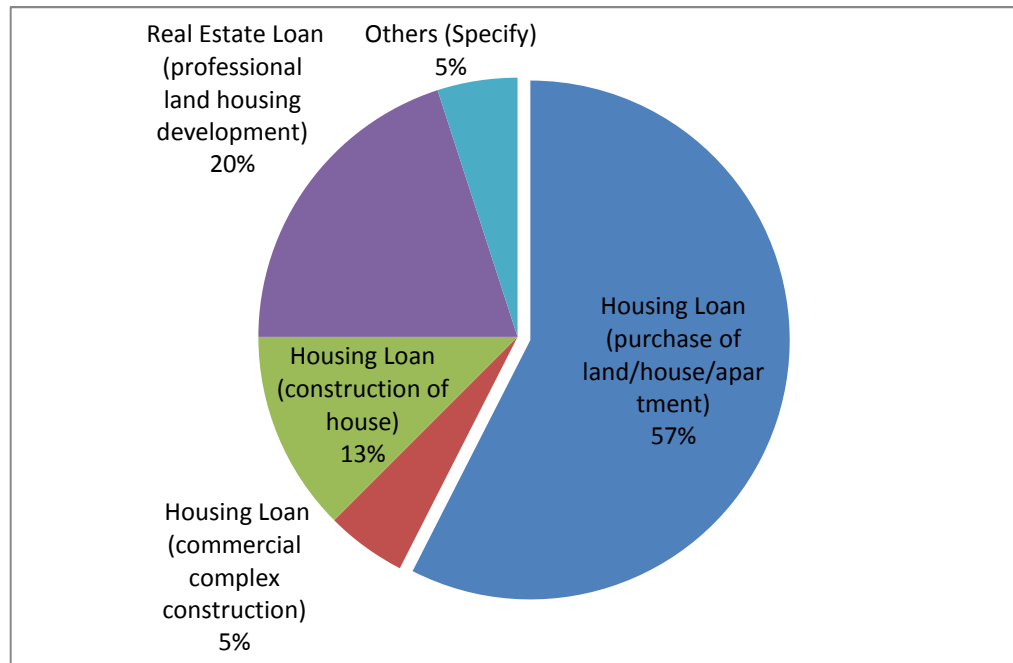
Respondents were asked to mention about the type of loan they have taken from bank and financial institutions. This question was created to know amount the average real estate loan amount maximum people are enjoying. The findings are summarized as follows:

Table 4.12
Types of Loan

S.No.	Particulars	Respondents	Percentage
1	Housing Loan (purchase of land/house/apartment)	23	57.5
2	Housing Loan (commercial complex construction)	2	5
3	Housing Loan (construction of house)	5	12.5
4	Real Estate Loan (professional land housing development)	8	20
5	Others (Specify)	2	5
	Total	40	100

Figure 4.12

Types of Loan



From the analysis of the above table it can be concluded that major respondents (57%) are enjoying housing loan to purchase land, house and apartment. 20% of the respondents have answered that they are enjoying real estate loan for professional purpose. Only 5% of the respondents have taken housing loan for commercial complex construction. Therefore it can be concluded that due to high urbanization and migration people have settled in Kathmandu valley by purchasing land house and apartments.

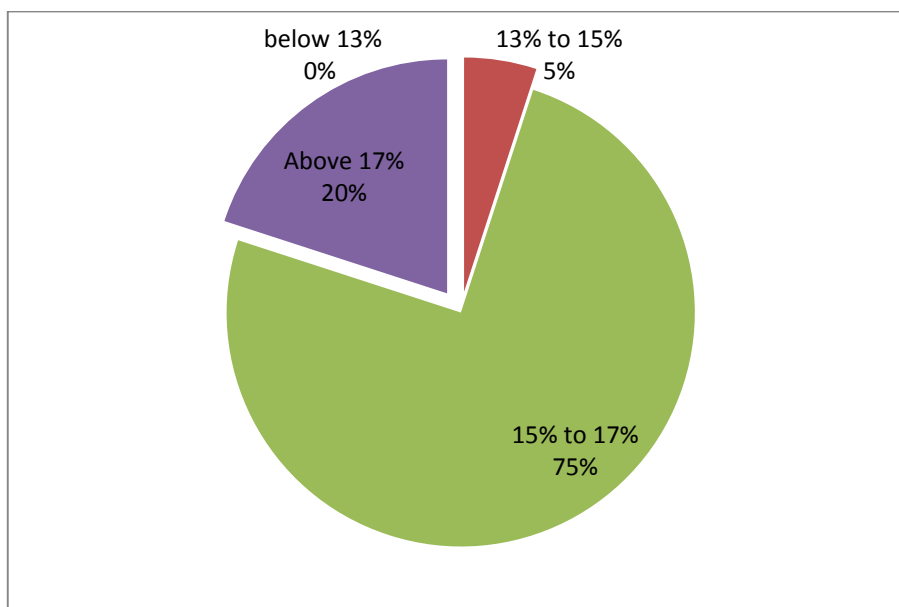
4.2.4 Interest Rate

Respondents were asked to mention about the interest rate of the loan amount the respondents have taken from bank and financial institutions. This question was created to know amount the average interest rate charged by the bank and financial institutions to the respondents. The findings are summarized as follows:

Table 4.13
Interest Rate

S.No.	Particulars	Respondents	Percentage
1	below 13%	0	0
2	13% to 15%	2	5
3	15% to 17%	30	75
4	Above 17%	8	20
	Total	40	100

Figure 4.13
Interest Rate



From the above table and figure it can be concluded that major no. of respondents (75%) have been charged the interest rate of 15% to 17%. 20% of the respondents have replied that they are being charged with an interest rate of above 17%. 5% of the respondents replied that they have been charged an interest rate of 13%-15%. None of the respondents replied that they have been paying less than 13% of interest rate. Therefore it can be said that major no. of respondents replied that they have been charged an interest rate of 15% to 17% which is a high rate of interest rate.

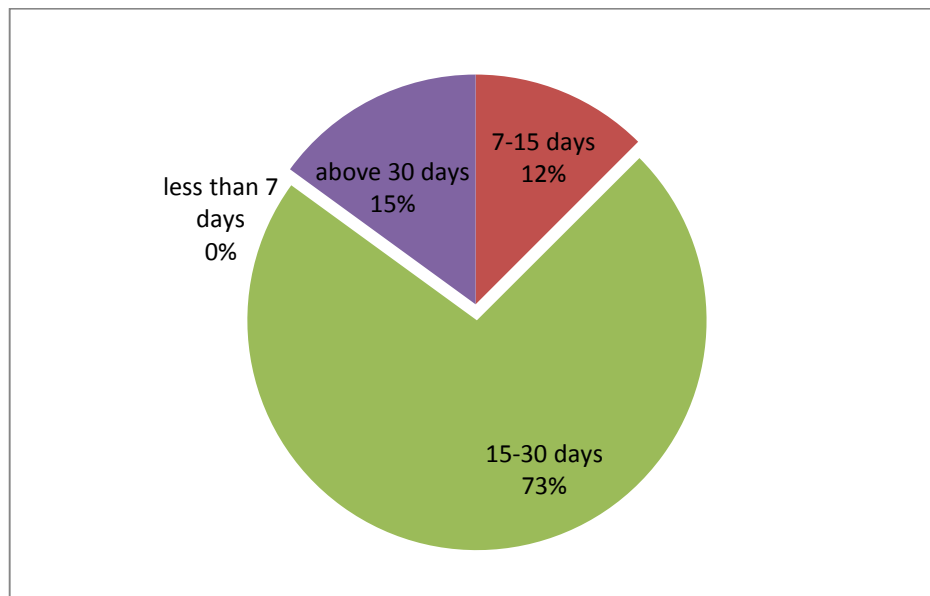
4.2.5 Loan Processing Time

Respondents were asked to mention about the loan processing time for the loan they have taken from bank and financial institutions. This question was created to know amount the average loan processing time. The findings are summarized as follows:

Table 4.14
Loan Processing Time

S.No.	Particulars	Respondents	Percentage
1	less than 7 days	0	0
2	7-15 days	5	12.5
3	15-30 days	29	72.5
4	above 30 days	6	15
	Total	40	100

Figure 4.14
Loan Processing Time



From the above table and figure it can be concluded that major no. of respondents (73%) it had taken 15-30 days for their loan processing time. 15% of the respondents have replied that they have taken above 30 days for the loan processing time. 12% of the respondents replied that it had taken 7-15 days for the loan processing. None of the respondents replied that it had taken

less than 7 days for the processing period. Therefore it can be said that major no. of respondents replied that it had taken 15-30 days to process the loan in a bank FI's.

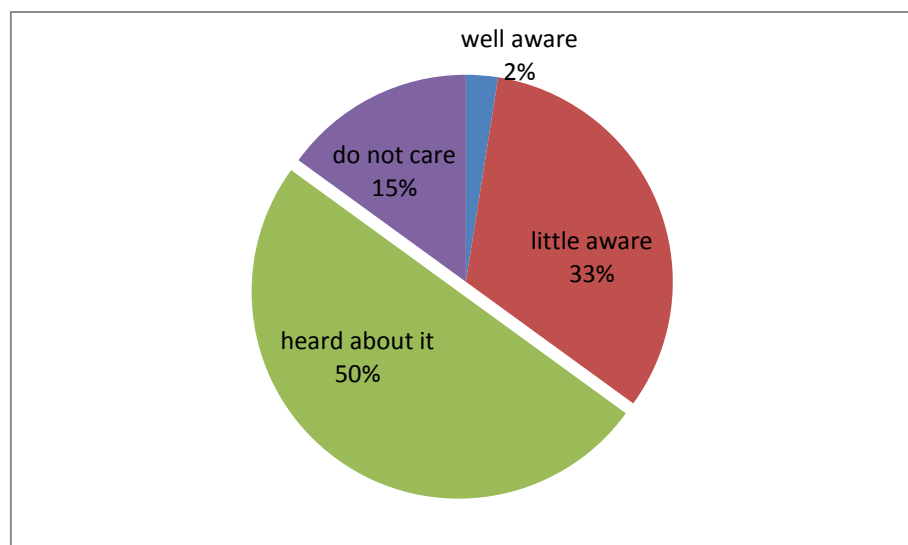
4.2.6 Awareness about NRB Directives

Respondents were asked to mention about the awareness about NRB directives regarding real estate and housing loan. This question was created to know amount the investors awareness. The findings are summarized as follows:

Table 4.15
Awareness about NRB Directives

S.No.	Particulars	Respondents	Percentage
1	well aware	1	2.5
2	little aware	13	32.5
3	heard about it	20	50
4	do not care	6	15
	Total	40	100

Figure 4.15
Awareness about NRB Directives



From the above table and figure it can be concluded that major no. of respondents (50%) replied that they have heard about the NRB directives regarding real estate loans. 33% of the respondents have replied that they are little aware about the NRB directives. 15% of the

respondents replied that they don't care about the NRB directives. 2% of the respondents replied that they are well aware about the NRB directives regarding NRB directives regarding real estate loan. Therefore it can be said that major no. of respondents have heard in any way about the directives and a few are well aware about it.

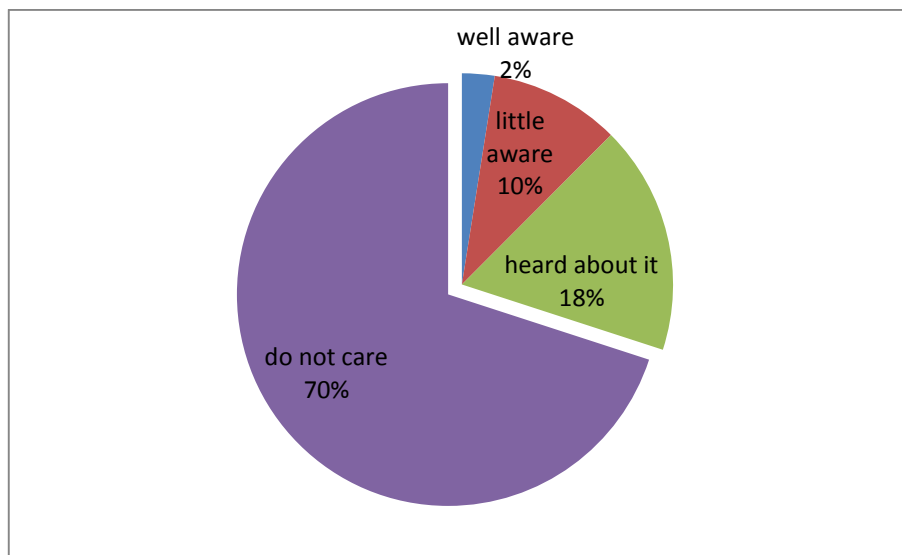
4.2.7 Differences between Real Estate & Housing Loan

Respondents were asked to mention about the difference between real estate loan and individual housing loan. This question was created to find out the awareness of investors between real estate loan and individual housing loan. The findings are summarized as follows:

Table 4.16
Difference between Real Estate & Housing Loan

S.No.	Particulars	Respondents	Percentage
1	well aware	1	2.5
2	little aware	4	10
3	heard about it	7	17.5
4	do not care	28	70
	Total	40	100

Figure 4.16
Difference between Real Estate & Housing Loan



From the above table and figure it can be concluded that major no. of respondents (70%) replied that they don't care about the differences between the real estate loan and individual housing loan. 18% of the respondents have replied that they have heard about it but don't know the difference. 10% of the respondents replied that they are little aware about it. 2% of the respondents replied that they are well aware about the difference. Therefore it can be said that major no. of respondents don't know what is real estate loan.

4.2.8 Reasons of Increasing Real Estate Loans

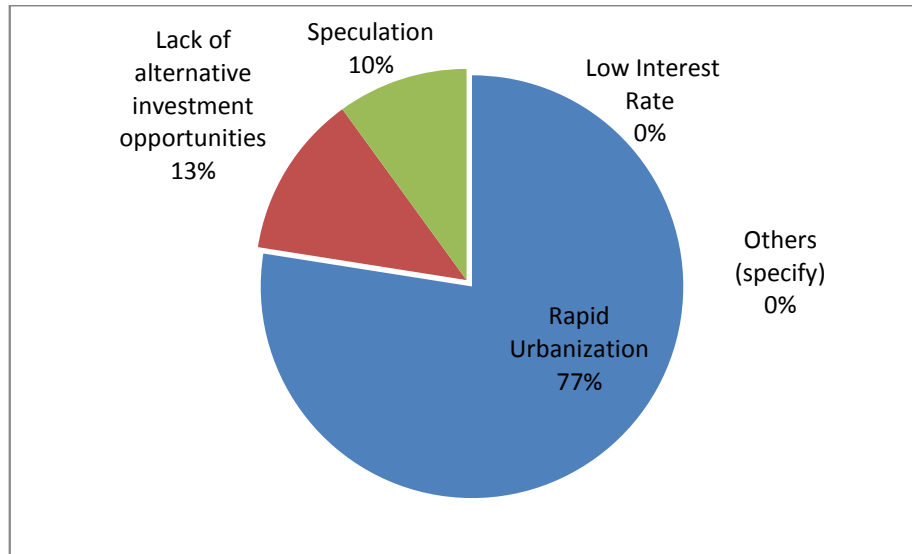
Respondents were asked to mention about reasons of increasing real estate loans. This question was created to know reason of increasing trend of real estate loan in Kathmandu valley. The findings are summarized as follows:

Table 4.17
Reasons of Increasing Real Estate Loans

S.No.	Particulars	Respondents	Percentage
1	Rapid Urbanization	31	77.5
2	Lack of alternative investment opportunities	5	12.5
3	Speculation	4	10
4	Low Interest Rate	0	0
5	Others (specify)	0	0
	Total	40	100

Figure 4.17

Reasons of Increasing Real Estate Loans



From the above table and figure it can be concluded that major no. of respondents (77%) replied that rapid urbanization is the main reason of increasing real estate loans. 13% of the respondents have replied that lack of alternative investment opportunities is the main reason of increasing real estate loan in Kathmandu valley. 10% of the respondents replied that speculation is the main reason behind it. None of the respondents replied due to low interest rate. Therefore it can be said that major no. of respondents has replied urbanization as the main reason of increasing real estate loan in Kathmandu valley.

4.2.9 Opinion towards NRB Directives

Respondents were asked to mention about their opinion toward new NRB directive. This question was created to know about the opinion of people regarding new rules imposed by NRB these days regarding real estate loan. The findings are summarized as follows:

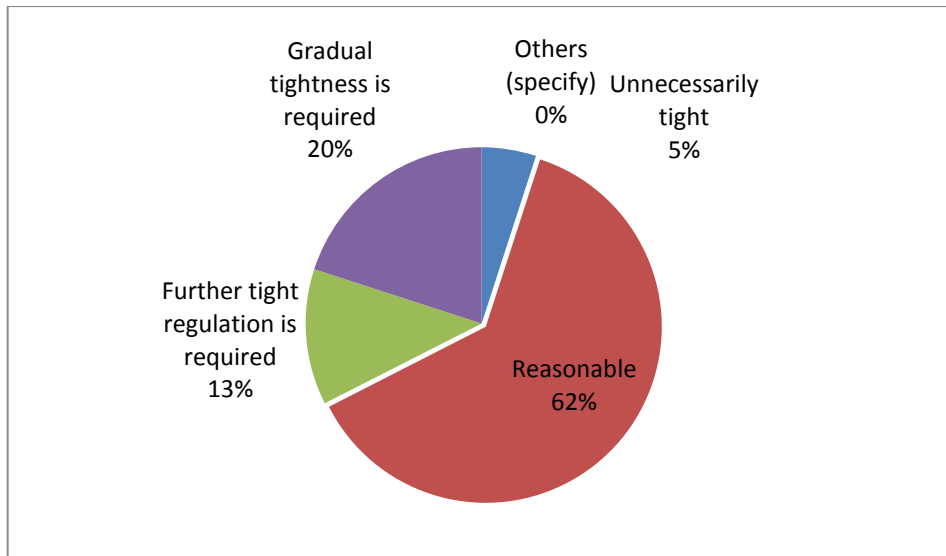
Table 4.18

Opinion towards NRB Directives

S.No.	Particulars	Respondents	Percentage
1	Unnecessarily tight	2	5
2	Reasonable	25	62.5
3	Further tight regulation is required	5	12.5
4	Gradual tightness is required	8	20
5	Others (specify)	0	0
	Total	40	100

Figure 4.18

Opinion towards NRB Directives



From the above table and figure it can be concluded that major no. of respondents (62%) replied that the rules imposed by NRB is reasonable. 20% of the respondents are of the opinion that the rules and regulations must be made gradually tight. 13% of the respondents replied that further tight regulation is required. 5% of the respondents replied that the rules and regulations are unnecessarily tight. Therefore major respondents replied the NRB directives provisions regarding real estate loan as reasonable.

4.3 Major Findings of the Study

-) The proportion of real estate loan in Nepalese financial institutions is increasing continuously despite the rules imposed by NRB recently. There is a steady growth in the amount of real estate loans.
-) The total portfolio of NABIL is higher than the total portfolio of HBL throughout the study period. Therefore it can be concluded that Nepalese commercial banks are being able to increase their lending portfolio annually. The growth ratio of loan and advances of NABIL is higher than that of HBL.
-) HBL is currently increasing its portfolio on real estate loan. while comparing the two sample banks under study the ratio was found to be higher in case of NABIL for the first three years of the study period but the same has been changed in the last two years of study period and HBL has higher lending i.e. 15.66% and 21.14% in comparison with 13.41% and 14.98% of NABIL.
-) Among the two banks, the NPL of HBL is higher than that of NABIL. Individually, the NPL level of NABIL is constantly increasing while the NPL of HBL is found to be fluctuating over the study period.
-) NABIL has set aside more funds to provision the NPL than HBL. The amount of provision made by both the bank to safeguard the NPL is in decreasing trend for the first three FY but the same has been increasing for the last two fiscal years. Comparatively NABIL has kept more provision for NPL than HBL except in FY 2010/11.
-) HBL is utilizing more of its deposit in real estate loan. This ratio is maximum in case of both NABIL and HBL in FY 2011/12.
-) Level of NPL of HBL is comparatively higher than the level of NABIL throughout the study period except FY 2011/12. The level of NPL of NABIL is continuously increasing throughout the study period. In case of HBL the amount is continuously increasing except in FY 2011/12. From the analysis it can be said that the NPL of NABIL is continuously increasing so its level should be maintained at time.
-) The ratio of NPL to real estate loan of HBL is higher than that of NABIL bank except in FY 2011/12. The ratio for HBL is higher in FY 2009/10 whereas the lowest in FY 2011/12. In case of NABIL its maximum in FY 2010/11 whereas minimum in FY 2007/08.

-) Majority of the respondents are enjoying loan amount in 1 million to 5 million.
-) Major customers are enjoying their loan facility from the organized sectors such as banks and financial institutions.
-) Major respondents (57%) are enjoying housing loan to purchase land, house and apartment. Therefore it can be concluded that due to high urbanization and migration people have settled in Kathmandu valley by purchasing land house and apartments.
-) Major no. of respondents replied that they have been charged an interest rate of 15% to 17% which is a high rate of interest rate.
-) Major no. of respondents replied that it had taken 15-30 days to process the loan in a bank FI's.
-) Major no. of respondents has heard in any way about the directives and a few are well aware about it.
-) Major no. of respondents doesn't know what real estate loan is.
-) Major no. of respondents has replied urbanization as the main reason of increasing real estate loan in Kathmandu valley.
-) Major respondents replied the NRB directives provisions regarding real estate loan as reasonable.

CHAPTER – IV

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

Housing is a basic need of every human beings, it provides security, pride and ownership. It has great significance in human life. Possession of the shelter is not required only for the protection against natural elements and hostile weather, but also for the maintenance of accepted standard of family and society. The real estate consisting of land or building with necessary living amenities makes better housing to live in. Housing and real estate sector plays an important role in civilization, social well-being and overall economic development of the country.

Housing finance contributes to social stability by enabling households to purchase the asset that is largest single investment. Personal residences account for 75 to 90 per cent of household wealth in emerging market countries. Furthermore, housing represents 15 to 40 per cent of the monthly expenditure of households worldwide. Globally, investment in the housing sector accounts for 15-35 per cent of aggregate investment.

Although several potential sources of housing finance for mid- and high-income consumers exist, most of the low-income families' needs are still unmet. Government subsidies tend to be insufficient or inappropriate; mortgage markets tend to serve only the richest 10-20 per cent of the population; housing microfinance is still an emerging industry; and informal systems are not efficient. Only 3 per cent of outstanding credit in low income countries is held in the form of housing loans compared to 27 per cent in high-income countries.

From a regional perspective, the mortgage markets in South Asia are small and fragmented though it has grown significantly during the last few years. Most of the countries have Housing Development Banks and commercial banks with housing finance in their product range. The housing portfolio of commercial banks including the specialized housing banks is growing significantly.

Housing supply in Kathmandu has been taking place almost entirely with private sector initiation. It is mainly financed from informal sources such as personal savings, sale of family assets (land and jewelry), family loans, and to some extent, provident-fund loans. In addition, the financing is also supported by loans from employers and banks. The Government of Nepal has given certain priority for urban development and housing program in Kathmandu Valley through its various plans and programs.

Nowadays, different private real estate developers and housing companies are involved in construction of low-price housing, apartments and commercial complex. The share of real estate sector in GDP has remained fairly constant with around 8.7 percent of GDP in the last decade while the growth rate has remained at 3.8 percent during the decade. The unprecedented rise in the price of housing and land has posed several questions even for macroeconomic stability. Not only this, the fast growth without much value addition in the economy is indicative of the real estate bubble that adversely impacts an economy. This is what the recent global financial crisis divulged. The central bank has initiated several efforts to curb down unhealthy practices in real estate activities through the regulatory framework for commercial banks and financial institutions.

The study has focused on various aspects of real estate financing and conducted a questionnaire survey to collect various information. From the thorough reviews and analysis of the data, the study has provided several findings. The major findings from primary data analysis are listed as follows:

-) Majority of the respondents are enjoying loan amount in 1 million to 5 million.
-) Major customers are enjoying their loan facility from the organized sectors such as banks and financial institutions.
-) Major respondents (57%) are enjoying housing loan to purchase land, house and apartment. Therefore it can be concluded that due to high urbanization and migration people have settled in Kathmandu valley by purchasing land house and apartments.
-) Major no. of respondents replied that they have been charged an interest rate of 15% to 17% which is a high rate of interest rate.
-) Major no. of respondents replied that it had taken 15-30 days to process the loan in a bank FI's.

-) Major no. of respondents has heard in any way about the directives and a few are well aware about it.
-) Major no. of respondents doesn't know what real estate loan is.
-) Major no. of respondents has replied urbanization as the main reason of increasing real estate loan in Kathmandu valley.
-) Major respondents replied the NRB directives provisions regarding real estate loan as reasonable.

5.2 Conclusion

As the housing and real estate sector plays an important role in employment generation and economic growth in the economy, it has been receiving priority. Banks and financial institutions have been finding it as an emerging sector and have been providing necessary financing. If BFIs fail to prevent risks associated with these loans, relax lending criteria, and grant more individual mortgage and housing development loans, then real estate bubbles may appear. The long-term nature of real estate investment has an adverse impact on the proper allocation of resources and creates distortions in the financial system. Ultimately, it poses questions for the financial health and for macroeconomic stability. It is high time to learn from experiences of other countries, review our practices and design a proper policy to develop and strengthen the real estate sector. Some of these relate to the following:

The housing and real estate market is still fresh in Nepal. There is a need to explore new products, modality of regulation and supervision. Credit Information Bureau only provides the information about the credit outstanding and list of defaulters. Hence, there is no system to examine credit worthiness of the borrowers. Some commercial banks simplified terms and conditions of the loan and formalities to speed up the process of real estate loans. Weak loan management unveils the risks associated with 'fake mortgage' and 'overvalued mortgage'. There is some sort of competition among the banks and financial institutions for the real estate loan. Banks and financial institutions provide mortgage finance, refinance and additional loans without proper assessment and analysis. The real estate credit has been curbed down within the specified limit after the directive issued by the NRB, though some of the banks and financial institutions are still striving to bring down the credit exposure within the specified limit.

5.3 Recommendations

The NRB has recently issued another directive related to real estate finance to relax the process of real estate loan classification. After this, the banks and financial institutions are not required to include the personal home loan (upto Rs 6.0 million) under real estate loan. Hence, the actual size of the real estate loan will appear smaller and is expected to be within the prescribed limit. However, this seems to be a short term remedial measure to address the immediate situation. Hence, policy related to the real estate financing should be introduced based on international experiences combined with Nepal's reality and requirements.

-) Real estate sector is one of the important economic sectors. The central bank needs to frame conducive policies to safeguard real estate financing and to ensure overall development of the sector.
-) A multi-tier real estate financing mechanism needs to be framed immediately. The current market is mainly composed of commercial banks and financial institutions and some investment companies, without specialized mortgage institutions and insurance companies.
-) Regulation and supervision mechanism of the real estate market should be improved to keep up with the public concern about the financial health and efficiency. Standards on real estate financial businesses need to be established promptly.
-) The NRB directives should not be directed only by the price movements and pressure from the major player of real estate market. They should mitigate public sentiments, consider the vulnerability of the sector and come up with the long-term policies.
-) It is highly desirable for NRB to pay close attention towards property prices in order to regulate and prevent financial risks through monetary and credit policies because the instability of the property market may directly lead to financial risks, endangering macro-economic stability.
-) Focus should be accorded for the use of workers' remittances in the productive sector as well as in infrastructure development. .
-) As there is no specific price index pertaining to the real estate or housing sector in Nepal, a real estate or housing price index needs to be developed.
-) There is a need to design legal framework governing the real estate market. Emphasis should be accorded to proper market supervision, early warning system and forward-looking risk-guidance.

-) Independent and specialized institutions particularly for asset management, credit rating, securitization and legal matters need to be developed. Such institutions are necessary for the sustainable development of the real estate sector.
-) Financing for real estate and housing business is an emerging concept. There is a need to explore new sources, products, and mechanism for the successful financing of the real estate sector.

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Appendix - I

Real Estate Loan Amt.

Year	NABIL	HBL
2007/08	3,123,678,000.00	2,189,546,000.00
2008/09	3,645,500,000.00	2,467,568,000.00
2009/10	4,617,286,000.00	2,944,546,000.00
2010/11	5,215,573,000.00	5,163,351,000.00
2011/12	6,421,646,000.00	7,603,894,000.00

Total Loan Amt.

Year	NABIL	HBL
2007/08	21,769,771,000.00	20,179,613,000.00
2008/09	27,589,933,000.00	25,519,137,000.00
2009/10	33,030,969,000.00	29,123,755,000.00
2010/11	38,905,481,000.00	32,968,270,000.00
2011/12	42,867,768,000.00	35,968,473,000.00

Non Performing Loan to Total Loan

Year	NABIL	HBL
2007/08	0.79	2.36
2008/09	0.80	2.16
2009/10	1.47	3.52
2010/11	2.32	3.92
2011/12	2.26	2.06

Total Loan Loss Provision to Total NPL

Year	NABIL	HBL
2007/08	236.05	142.62
2008/09		

	181.96	128.49
2009/10	155.05	111.58
2010/11	102.18	105.74
2011/12	126.68	126.93

Provision for Possible Losses

Year	NABIL	HBL
2007/08	64,500,000.00	52,970,000.00
2008/09	45,722,000.00	56,303,000.00
2009/10	345,986,000.00	487,070,000.00
2010/11	161,528,000.00	226,031,000.00
2011/12	516,588,000.00	74,293,000.00

Total Deposits

Year	NABIL	HBL
2007/08	31,915,047,000.00	31,939,866,000.00
2008/09	37,348,256,000.00	34,746,301,000.00
2009/10	46,406,308,000.00	37,665,526,000.00
2010/11	49,696,113,000.00	40,920,627,000.00
2011/12	55,023,695,000.00	47,730,994,000.00

Real Estate Loan to Total Loan

Year	NABIL	HBL
2007/08	14.35	10.85
2008/09	13.21	9.67
2009/10	13.98	10.11

2010/11	13.41	15.66
2011/12	14.98	21.14

Real Estate Loan to Total Deposits

Year	NABIL	HBL
2007/08	9.79	6.86
2008/09	9.76	7.10
2009/10	9.95	7.82
2010/11	10.49	12.62
2011/12	11.67	15.93

Non Performing Loan Amount

Year	NABIL	HBL
2007/08	171,981,190.90	476,238,866.80
2008/09	220,719,464.00	551,213,359.20
2009/10	485,555,244.30	1,025,156,176.00
2010/11	902,607,159.20	1,292,356,184.00
2011/12	968,811,556.80	740,950,543.80

Non Performing Loan to Real Estate Loan

Year	NABIL	HBL
2007/08	5.51	21.75
2008/09	6.05	22.34
2009/10	10.52	34.82
2010/11	17.31	25.03
2011/12	15.09	9.74

QUESTIONNAIRE

I hereby request you to fill up the questionnaire designed for proposed survey of the surveyor. The precious views and opinions from your side will be helpful for facilitating the research entitled “**IMPACT OF NRB DIRECTIVES IN REAL ESTATE FINANCING (A CASE STUDY OF KATHMANDU VALLEY)**”. The views expressed by you here in the questionnaire will be used for the research purpose only and kept confidential.

Name (Optional) :

Address :

Qualification :

Occupation :

1. What is the amount of the loan you are enjoying from a Bank FI's?

- a. less than Rs.1,000,000.00
- b. Rs.1,000,000.00 to Rs.5,000,000.00
- c. Rs.5,000,000.00 to Rs.10,000,000.0
- d. Above Rs. 10,000,000.00

2. What kind of institution you are using to take loan?

- a. Commercial Banks
- b. Development Banks
- c. Finance Companies
- d. Cooperatives
- e. Personal Lenders

3. What kind of loan you are enjoying?

- a. Housing Loan (purchase of land/house/apartment)
- b. Housing Loan (commercial complex construction)
- c. Housing Loan (construction of house)
- d. Real Estate Loan (professional land housing development)
- e. Others (Specify)

- 4. How much interest rate are you being charged for the loan?**
- a. below 13%
 - b. 13% to 15%
 - c. 15% to 17%
 - d. Above 17%
- 5. How much time did the Bank/FT's took to grant you the loan?**
- a. less than 7 days
 - b. 7-15 days
 - c. 15-30 days
 - d. above 30 days
- 6. How much are you aware about the tight rules imposed by NRB regarding real estate loans?**
- a. well aware
 - b. little aware
 - c. heard about it
 - d. do not care
- 7. How much aware are you regarding the differences between real estate loan and residential housing loans?**
- a. well aware
 - b. little aware
 - c. heard about it
 - d. do not care
- 8. What are the main reasons for increasing demand for real estate loans?**
- a. Rapid Urbanization
 - b. Lack of alternative investment opportunities
 - c. Speculation
 - d. Low Interest Rate
 - e. Others (specify)
- 9. How is the current price movement of land/house/plot rate in Kathmandu Valley?**
- a. Increasing

10. What is your opinion regarding changes in NRB Directives to the Bank FI's for real estate lending?

- a. Unnecessarily tight
- b. Reasonable
- c. Further tight regulation is required
- d. Gradual tightness is required
- e. Others (specify)

Thank You!